



**Faulu**   
A MEMBER OF THE  **OLDMUTUAL GROUP**

Expect More From Your Bank

**2019** Annual Report



## KARIBU

TO THE BANK  
THAT UNDERSTANDS  
YOUR NEEDS



# CONTENTS

01

OVERVIEW

Corporate Information 09

Board of Directors 10

Senior Management 18

Chairman's Statement 24

Managing Director's Statement 28

Sustainability Review 32

Corporate Social Responsibilities 43

Report of the Directors 49

02

PERFORMANCE  
REVIEW

Corporate Governance Statement 53

Statement of Directors' Responsibilities 59

03

GOVERNANCE  
REPORTING

Independent Auditor's Report 60

Statement of Profit or Loss and other Comprehensive Income 63

04

FINANCIAL  
REVIEW

Statement of Financial Position 64

Statement of Changes in Equity 65

Statement of Cash Flows 67

Notes to the Financial Statements 69

**Reports and Financial Statements**  
for the year ended 31 December 2019

FAULU PURPOSE:

**CHAMPIONING MUTUALLY POSITIVE FUTURES EVERYDAY**



## Faulu at a GLANCE



### 61 Banking Outlets

- ▶ **Baringo County**  
Kabarnet
- ▶ **Bomet County**  
Bomet
- ▶ **Bungoma County**  
Bungoma  
Kimilili
- ▶ **Busia County**  
Busia
- ▶ **Elgeyo Marakwet County**  
Iten
- ▶ **Embu County**  
Embu
- ▶ **Homabay County**  
Homabay
- ▶ **Kajiado County**  
Rongai  
Kiserian  
Kitengela
- ▶ **Kakamega County**  
Kakamega  
Mumias
- ▶ **Kabarnet County**  
Kabarnet
- ▶ **Kericho County**  
Litein  
Kericho
- ▶ **Kiambu County**  
Thika  
Kiambu  
Limuru
- ▶ **Kilifi County**  
Kilifi
- ▶ **Kirinyaga County**  
Malindi
- ▶ **Kisumu County**  
Kisumu
- ▶ **Kitui County**  
Matuu  
Mwingi  
Kitui
- ▶ **Kwale County**  
Ukunda
- ▶ **Laikipia County**  
Nyahururu  
Nanyuki
- ▶ **Machakos County**  
Machakos
- ▶ **Makueni County**  
Emali
- ▶ **Meru County**  
Makutano  
Meru  
Maua
- ▶ **Migori County**  
Migori
- ▶ **Mombasa County**  
Changamwe  
Kengeleni  
Moi Avenue
- ▶ **Muranga County**  
Muranga
- ▶ **Nairobi County**  
Ngong Road  
Kawangware  
OTC  
Kibera  
Kimathi Street  
Jeevanjee  
Kariobangi  
Kayole  
Githurai  
Gikomba
- ▶ **Naivasha County**  
Naivasha
- ▶ **Nakuru County**  
Nakuru  
Molo  
Njoro
- ▶ **Narok County**  
Narok
- ▶ **Nyeri County**  
Nyeri  
Karatina
- ▶ **Siaya County**  
Bondo  
Ugunja
- ▶ **Transnzoia County**  
Kitale
- ▶ **Taita-Taveta County**  
Voi  
Taveta
- ▶ **Uasin Gishu County**  
Eldoret
- ▶ **West Pokot County**  
Kapenguria



Mobile Banking  
Registered Customers  
**452,094**



**2000**  
VISA ATMS  
Countrywide



**500**  
Agents  
Countrywide



**1349**  
Employees

## Our Service OFFERING

- ▶ Faulu Microfinance Bank provides a one-stop shop solution for our customers' financial needs. Our collective financial solutions are tailor made to suit our customer's short-term and / or long-term goals.

It is always our pleasure to partner with individuals and corporates to provide the following financial services:

### TRANSACTIONAL SAVINGS ACCOUNTS



- Personal Current Accounts
- Personal Savings Accounts
- Business Current Accounts

### INVESTMENT ACCOUNTS



- Fixed deposits Accounts
- Call deposits Accounts
- Contractual Accounts

### CREDIT FACILITIES



- Salary-backed loans
- SMEs & Corporate loans
- Micro loans
- Agri-business loans

### BANCASSURANCE



- General Insurance Products
  - Medical Insurance
  - Motor Insurance
  - SME Insurance
- Life Insurance Products
  - Education/Endowment policy
  - Last Expense Policy
  - Personal Accident
  - Savings



**FAULU  
MKONONI**

**\*339#**

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**Faulu**   
A MEMBER OF THE  **OLDMUTUAL GROUP**



FINANCIAL REPORTING AWARD

6 years of winning  
the Fire Award



*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2016*  
Faulu Microfinance Bank  
**WINNERS**  
Micro Finance Institutions  
Category

*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2015*  
Faulu Micro-Finance Bank Limited  
**WINNERS**  
Micro Finance Institutions  
Category

*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2013*  
Faulu Kenya DTM Limited  
**WINNERS**  
Micro Finance Institutions Catego

*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2019*  
Faulu Microfinance  
**WINNERS**  
Microfinance Category

*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2017*  
FAULU MICROFINANCE BANK  
**WINNERS**  
Micro Finance Institutions Category

*FiRe*  
FINANCIAL REPORTING AWARD  
*Awards 2018*  
FAULU MICROFINANCE BANK

## Corporate Information

### Board of Directors

▶ Dr. Peter W. Muthoka	Non- Executive Chairman	
Apollo N. Njoroge	Managing Director	
Peter J Mogan*	Non- Executive Director	
George Maina	Non- Executive Director	
Joshua Muiru	Non- Executive Director	
Peter Gachuba	Non-Executive Director	
Peter K. Mwangi	Non- Executive Director	
Dr. Catherine N. Kimura	Non- Executive Director	
Sophia Mukoba	Non- Executive Director	
Andre Keller**	Non- Executive Director	Appointed 7 May 2019

#### Audit Committee

Joshua Muiru  
Sophia Mukoba  
Peter Mogan

#### Innovations and Technology Committee

George Maina  
Peter Gachuba  
Joshua Muiru  
Apollo Njoroge

#### Risk and Compliance Committee

George Maina  
Joshua Muiru  
Peter K. Mwangi

#### Remuneration and Nominations Committee

Dr. Peter W. Muthoka  
George Maina  
Peter K. Mwangi

#### Credit Committee

Peter Gachuba  
Dr. Catherine Kimura  
Andre Keller

#### Registered office

Ngong Lane. Off Ngong Road  
P O Box 60240 00200 - Nairobi

#### Company Secretary

Nkirote K. Mworira  
UAP Old Mutual Towers Upperhill Road,  
P.O. Box 43013-00100 Nairobi, Kenya

#### Principal Banker

Standard Chartered Bank Kenya Limited  
Yaya Centre Branch  
P O Box 40310  
00100 - Nairobi

#### Auditors

Deloitte & Touche  
Certified Public Accountants (Kenya)  
Deloitte Place, Waiyaki Way, Muthangari  
P O Box 40092  
00100 - Nairobi

#### Principal Lawyers

Daly & Inamdar Advocates  
6th Floor, ABC Towers, ABC Place,  
Waiyaki Way  
P.O. Box 40034, Nairobi 00100 Kenya

\*Canadian \*\*South African

## Board of Directors

### From Left to Right ( Standing )

**Nkirote M. Njiru** (Company Secretary)  
**Andre W. Keller** (Non Executive Director)  
**Dr. Catherine N. Kimura** (Non Executive Director)  
**George A. Maina** (Non Executive Director)  
**Apollo N. Njoroge** (Managing Director)  
**Peter J. Mogan** (Non Executive Director)

### From Right to Left (Sitting)

**Dr. Peter Wanyaga Muthoka** (Chairman)  
**Peter N. Gachuba** (Non Executive Director)  
**Sophia A. Mukoba** (Non Executive Director)  
**Joshua S. Muiru** (Non Executive Director)  
**Peter K. Mwangi** (Non Executive Director)





### DR. PETER WANYAGA MUTHOKA

D.ML, MA(Ed), BA (Hons), EBS,  
MBS, FKIB, FKIM, MID

CHAIRMAN



#### Qualification:

- Honorary Degree of Doctor of Management and Leadership (D.ML) (Honoris Causa)
- The Management University of Africa (MUA) MA (Education), with special reference to UN Agencies
- University of California, Los Angeles (UCLA)
- BA Economics & History (Hons), University of East Africa, Nairobi Campus

**Year of Birth:** 1943

**Date of Appointment:** 26 March 2014

#### Experience:

Dr. Muthoka is the Chancellor of Masinde Muliro University of Science and Technology (MMUST). Previously, Dr. Muthoka has served as Group Chairman of Kenya Commercial Bank. He is now the current Chairperson of the Board of Directors Faulu Microfinance Bank Limited and the Board of Trustees UAP

Old Mutual Foundation.

Through his illustrious career, Dr. Muthoka has been a corporate leader and an entrepreneur with long and varied experience in public and private sectors in the fields of Management, Education, Finance, Investment, Export Promotion, Agriculture, Real Estate, Corporate Governance, International Diplomacy, and Community Voluntary work.

In recognition of his exemplary service within the Kenyan public service and international organizations, the president of the Republic of Kenya awarded him with the medal of Moran of the Burning Spear (MBS) in 2004 and the Medal of Elder of the Burning Spear (EBS) in 2012.

### PETER K. MWANGI

NON EXECUTIVE DIRECTOR



#### Qualification:

- BSc. Electrical Engineering, University of Nairobi
- Certified Public Accountant CPA (K)
- Certified Financial Analyst - CFA Charter Holder
- Chartered Public Secretary CPS (K)

**Year of Birth:** 1969

**Date of Appointment:** 11 March 2015

#### Experience:

Peter joined Old Mutual Kenya as the Chief Executive Officer in October 2014 from Nairobi Securities Exchange and later became the Group CEO following the merger of UAP and Old Mutual. He now heads the UAP Old Mutual Group Business which also includes Faulu Microfinance Bank Limited.

At NSE, he served as the Chief Executive

Officer for six (6) years, during his time Peter was credited with, amongst other things, the successful Demutualization and Self-Listing of the NSE.

Prior to this, Peter was the Managing Director of Centum Investments Limited which is one of the Kenya's largest publicly quoted investment company. Early in his career, Peter served in the Kenya Air force and held the rank of captain.

He sits on the UAP Old Mutual Group Board in; Kenya, Uganda, Tanzania, Rwanda, South Sudan, Boards as an Executive Director.

**GEORGE A. MAINA**

NON EXECUTIVE DIRECTOR

**Qualification:**

B. Tech (Hons) Aeronautical Engineering and Design from Loughborough University - United Kingdom

**Year of Birth:** 1952

**Date of Appointment:** 2003

**Experience:**

George began his career in aeronautical engineering and went on to serve in the capacity of deputy Managing Director and Marketing Manager for the Shell Company in Jamaica, Ghana and East Africa markets. Through his experience, George gained expertise in various sectors including: Strategy development and Implementation, Governance, Organization Development / Re-engineering and Capacity Building, Change Management, Risk Management, Finance and Investment Management, Mergers, Acquisitions and Exits as well as

Investment Banking.

He joined the Faulu Board in 2003 and has been instrumental in leading the restructuring and divestiture of the bank. George is currently a Director at UAP Old Mutual Holdings Limited.

**COMNR. PETER N. GACHUBA**

NON EXECUTIVE DIRECTOR

**Qualification:**

- MSc. International Business – Southern New Hampshire University, Manchester, NH, USA BSc. Accounting, Southern New Hampshire University, Manchester, NH, USA
- Executive Courses from Harvard Business School – USA and Wharton Business School USA

**Year of Birth:** 1964

**Date of Appointment:** 16 March 2015

**Experience:**

Peter is an investment banker with many years of business experience. He has worked in Commercial banking, Investment banking and Private Equity for nearly 20 years. He has served in the Board of Equity Bank and other Microfinance Banks outside Kenya such as Opportunity Bank in Malawi, Socremo in Mozambique, Pride in Uganda

and Pride in Tanzania.

Earlier in his career, he was a Corporate Finance Manager at KPMG, Investment Officer at CDC Capital, General Manager of Kestrel Capital, Head of Investment & Merchant Banking in Cooperative Bank and also worked as a Consultant for the World Bank in Nairobi.

He is currently a Commissioner in the Commission of Revenue Allocation in Kenya.

**DR. HON. CATHERINE N. KIMURA**

**NON EXECUTIVE DIRECTOR**



**Qualification:**

- Bachelor of Arts Degree (Hons) from the University of Nairobi
- Diploma in Tourism and International Relations (University of Paris)
- Certificate in Public Finance (University of Connecticut)
- Certificate in Budgeting (Harvard Institute)

**Year of Birth:** 1943

**Date of Appointment:** 14 February 2018

**Experience:**

Dr. Hon. Catherine Kimura is a specialist in Public Finance and Policy and Management with over 37 years' experience.

She has held enviable positions in the government and public service including Investment Secretary - Ministry of Finance as well as Member of Parliament - East African Legislative Assembly (EALA) and the

first Chancellor of Multimedia University of Kenya.

She has previously served as a Director of KCB Bank Kenya and currently serves as a Director of Old Mutual Securities Limited. Her vast experience is beneficial to Faulu's overall strategic planning, management and finance.

**JOSHUA S. MUIRU**

**NON EXECUTIVE DIRECTOR**



**Qualification:**

- Master of Arts in Economics, University of Nairobi
- Bachelor of Arts in Economics, University of Nairobi
- Executive Courses in Corporate Governance, Debt Management, Financial Analysis and Policy and Public Finance

**Year of Birth:** 1950

**Date of Appointment:** 30 March 2015

**Experience:**

Joshua is an economist with extensive experience in the banking industry having worked with the Central Bank of Kenya for over 23 years. He has also worked with the Industrial and Commercial Development Corporation, Kenya Industrial Estates and has been a Director at KCB Rwanda and KCB Tanzania.

He also has vast training and experience in policy formulation and corporate governance. Consequently, he is a seasoned member of the Institute of Directors of Kenya and a Consultant for Kenya Institute of Bankers.

**SOPHIA A. MUKOBA****NON EXECUTIVE DIRECTOR****Qualification:**

- Masters of Business Administration, University of Nairobi
- Bachelor of Commerce - Accounting Option
- Certified Public Accountant CPA (K)
- Member of the Chartered Institute of Management Accountants (CIMA)

Touche. Her expertise in financial and audit matters are of great value to the Faulu Board.

**Year of Birth:** 1975

**Date of Appointment:** 14 February 2018

**Experience:**

Sophia is a seasoned finance professional with over 18 years' experience spanning across Audit, Control Management Accounting and Commercial Finance. Sophia has held various Senior Finance roles and is currently the Finance Director for Unilever East Africa. Prior to joining Unilever, she worked at British American Tobacco Kenya Limited and Deloitte &

**PETER J. MOGAN****NON EXECUTIVE DIRECTOR****Qualification:**

- Bachelor of Law – Osgoode Hall Law School
- Attorney of Law in Society of Columbia
- Member of Law Society of British Columbia

**Year of Birth:** 1952

**Date of Appointment:** 4 July 2014

**Experience:**

Peter has been an active lawyer, businessman and mediator in British Columbia and Ontario with a career spanning over 37 years.

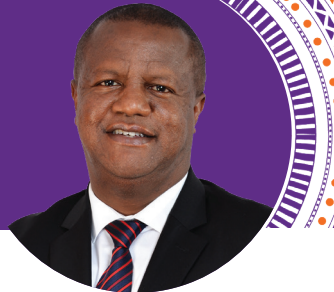
He is highly skilled in mergers and acquisitions, contract negotiations, international trade, dealings with government, tax planning and securities compliance for both publicly listed and private companies.

Peter also has extensive experience in facilitating Leadership Development, Strategic Planning, Conflict Management and Community Building Workshops for Business, Government and Not-for-profit Organizations in six continents.

He currently serves as a Director on or Corporate Secretary to the Boards of several British Columbia companies as well as a number of charities. He is also actively involved with Global Mothers, a new social enterprise targeting poverty alleviation in the developing world through trade.

**APOLLO NJORGE**

**MANAGING DIRECTOR**



**Qualification:**

- Graduate of IESE Business School in Spain
- Masters' Degree in International Business Administration (Finance Option), United States International University
- Executive Management- Strathmore Business School
- Bachelor of Science Degree (Hons) in Mathematics and Physics University of Nairobi

**Year of Birth:** 1970

**Date of Appointment:** 19 December 2016

**Experience:**

Apollo is an experienced financial executive with over 24 years' experience in Retail, Micro, Small and Medium Enterprises Banking across East Africa. He joined Faulu Microfinance Bank Limited as the Managing Director and Chief Executive Officer. Prior to his appointment, he was the Ag. Managing Director, Equity Bank in Uganda, where he also held the positions of

Executive Director and Chief Operations Officer. He has held the following positions at Equity Bank in Kenya; General Manager in charge of Business Relationships and Head of Business Growth & Development. He has also worked in African Banking Corporation Limited and Investments & Mortgages Bank. Apollo's achievements during his tenure at Equity, were commendable and include: Strategy formulation and implementation which led to the acquisition of a micro finance institution in Uganda and its eventual growth into a fully-fledged profitable bank in the top ten (10). He is also credited with leading the change process for the rollout of a new banking software, documentation of procedures and supporting the team to transition to a commercial bank. He is currently the vice chairperson of the Association of Microfinance Institutions in Kenya (AMFI-K).

**ANDRE W. KELLER**

**NON EXECUTIVE DIRECTOR**



**Qualification:**

- B. Com (Hons) in Accounting – University of South Africa
- Bachelor of Accountancy - University of Potchefstroom, South Africa

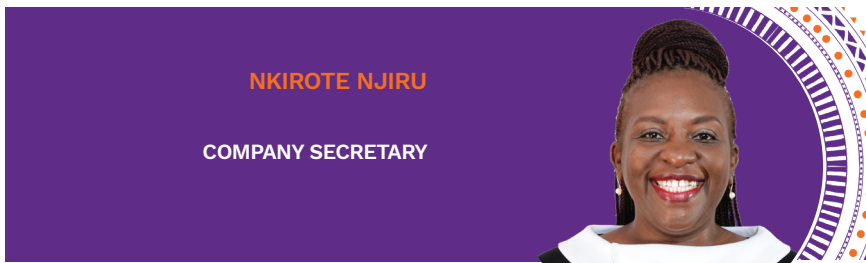
**Year of birth:** 1979

**Date of appointment:** 7th May 2019

**Experience:**

Andre is a Chartered Accountant and has more than 18 years' experience in Finance, Treasury and Risk Management across South Africa, UK and Africa which he gained from the Old Mutual Group, Royal Bank of Scotland, Dexia Bank, UK and the accounting profession in South Africa. He has a track record of delivering insightful analysis that influence strategic decision making.

Andre has previously worked as: the Head of Banking Rest of Africa and the CFO Banking Cluster for Old Mutual South Africa, Head of Planning and Management, Executive Decision Support Manager and Business Intelligence Manager for the Royal Bank of Scotland in UK, Finance and Market Risk Manager for Dexia Bank Belgium, UK and IFRS Accountant for Dexia Banque Internationale Luxembourg, UK. Andre is a Member South African Institute of Chartered Accountants.



**Qualification:**

- Global Executive Masters in Business Administration jointly offered by United States International University (Kenya) and Columbia Business School (New York, USA)
- Master of Laws in Commercial Law - University of Cape Town (Republic of South Africa)
- Bachelor of Laws Degree - University of Reading (United Kingdom)
- Higher National Diploma in Law (Kenya)
- Higher National Diploma in Human Resource Management (Kenya)

**Year of Birth:** 1973

**Date of Appointment:** 21 August 2017

**Experience:**

Nkirote is a certified public secretary and lawyer with a passion for corporate governance, standard setting and policy

making. She is an Advocate of the High Court of Kenya, an active member of the Law Society of Kenya and a fellow of the Institute of Certified Public Secretaries of Kenya where she has been an elected member of the Council and is currently serving as the Vice chairperson of the Institute.

In her twenty years of practice, Nkirote has worked in both public and private sectors in Kenya in several sub-sectors including telecommunications, retirement benefits and insurance in a wide- range of activities involving setting-up of legal and governance structures, legal and regulatory risk analysis, monitoring developments in legal research, legal policy development, legislative drafting, industry supervision and capacity building.

**Faulu**  
A MEMBER OF THE OLD MUTUAL GROUP

**WE ACKNOWLEDGE AND APPRECIATE YOUR HARDWORK.**

## Senior Management

### From Left to Right ( Standing )

Sheila Maina, David Mukaru, Grace Thiong'o,  
Julius Taliani, Peter Iha, Rose Kimani,  
Michael Kalii

### From Right to Left (Sitting)

Paul Kahoro, Apollo N. Njoroge,  
Nahashon Ojode, Maureen Mbori

Coming together is a beginning.  
Keeping together is progress.  
Working together is success.

~ Henry Ford







**Apollo Njoroge**  
Managing Director

Apollo is an experienced financial executive with over 24 years' experience in Retail, Micro, Small and Medium Enterprises Banking across East Africa. He joined Faulu Microfinance Bank Limited as the Managing Director and Chief Executive Officer.

Prior to his appointment, he was the Ag. Managing Director, Equity Bank in Uganda, where he also held the positions of Executive Director and Chief Operations Officer. He has held the following positions at Equity Bank in Kenya; General Manager in charge of Business Relationships and Head of Business Growth & Development. He has also worked in African Banking Corporation Limited and Investments & Mortgages Bank.

Apollo's achievements during his tenure at Equity, were commendable and include: Strategy formulation and implementation which led to the acquisition of a micro finance institution in Uganda and its eventual growth into a fully-fledged profitable bank in the top ten (10). He is also credited with leading the change process for the rollout of a new banking software, documentation of procedures and supporting the team to transition to a commercial bank.

He is currently the vice chairperson of the Association of Microfinance Institutions in Kenya (AMFI-K).



**Julius Taliani**  
Head of Finance & Strategy

Julius joined Faulu in October 2016 as the Head of Finance. He was later appointed as Head of Finance and Strategy in May 2017. He has worked for over 15 years specializing in Finance and Accounting in the Banking and Insurance sectors.

Prior to joining Faulu, he was the Chief Finance Officer at Invesco Assurance Co. Ltd. He also previously worked with Old Mutual Kenya as the Finance Manager-Operations and with KCB (Sudan) Ltd. as the Finance & Administration Manager. Julius is widely experienced in strategic planning, business systems re-engineering, process restructuring for operational efficiency, cost management and risk & compliance monitoring. He also has an outstanding track record in coaching and developing high performance cross-functional teams.

He has an MBA (Finance) and a B.Com (Accounting) both from the University of Nairobi and is a qualified Certified Public Accountant, CPA (K). He holds memberships with the Institute of Certified Public Accountants (I.C.P.A.K) and the Kenya Institute of Bankers (K.I.B).



**Grace Thiong'o**  
Head of Risk & Compliance

Grace has over 15 years Risk management, Compliance management and Audit experience.

She joined Faulu Bank in January 2017 as Head of Risk and Compliance.

She is a Certified Public Accountant of Kenya, a Certified Internal Auditor (CIA) and a Member of the Institute of Internal Auditors in Australia (MIIA) with an MBA from the Melbourne Business School, a Risk Certification from the Harvard Business School (HBS) and Bachelor of Commerce (Hons) from the University of Nairobi. She is also a scholarship recipient for the Women in Leadership Program at the Melbourne Business School (MBS).

Grace has held several management roles including in Group Audit, Risk & Compliance Management and Assurance at Australia New Zealand (ANZ) Banking Group reviewing the Bank's business and operations across Australia, New Zealand and South East Asia. Before joining the Australia New Zealand (ANZ) Banking Group, she worked at Deloitte in Nairobi and Melbourne.



**Nahashon Ojode**  
Head of Credit

Nahashon career as a banker, spans over 19 years. He has worked in a cross-section of institutions in Kenya and in the wider East African region.

He was the General Manager Credit, Equity Bank Rwanda Limited, where he successfully supported the setting up of the subsidiary. He previously held the following positions at Equity Bank in Kenya; Credit Manager, and Credit Risk Manager before his appointment as the Head of Credit, Equity Bank Southern Sudan. Nahashon has also worked at Family Bank and Standard Chartered Bank in various capacities where he grew from a junior position to management level.

He has valuable experience in retail, micro, small and medium Enterprises Banking covering lending, relationship management and product development.

Nahashon is pursuing a PhD in Business administration at Kenyatta University, holds a Msc. degree in Entrepreneurship Development from Kenyatta University and a Bsc. degree from Moi University besides credit, leadership and strategy courses.



**Paul Kahoro**  
Head of Audit

Paul joined Faulu Microfinance Bank in July 2006 as an Internal Audit Officer and grew through the ranks after serving in various capacities within the Internal Audit function. Prior to being appointed the Head of Internal Audit in 2012, Paul held various leadership positions including Senior Auditor, Information's Systems, Audit Manager and Senior Audit Manager.

Mr Kahoro has a wealth of experience in Audit having started his career at PKF Audit Firm where he had exposure in auditing clients in different sectors of the economy including Banking, Service, Manufacturing and Retail. After joining Faulu, Paul also played a big role in the transformation of the bank from Credit only to a Deposit Taking Microfinance having been seconded to a transformation team which dealt with process and system transformation. His audit experience spreads across the organization value chain which include credit, banking operations, Information Technology, Finance, and HR.

Paul is a Certified Public Accountant CPA (K) and member of ICPAK. He is a Certified Information Systems Auditor (CISA), Certified Internal Auditor and holds bachelor's degree in Agribusiness Management.



**Maureen Mbori**  
Head of Treasury

Maureen joined Faulu in October 2016 as the Head of Treasury and is now in charge of Treasury, Institutional Banking and Partnerships at Faulu bank. She has over 10 years' experience in the banking industry after previously working for National Bank as Fixed Income & Money Market Dealer, Eco-Bank Kenya as Asset and Liability Officer, NIC Bank as Fixed Income & Money Market Dealer and Treasury Officer at I&M Bank.

She has successfully managed the bank's treasury function by ensuring efficient Portfolio Management, Financial Risk management, Liquidity Risk Management and Investment Income analysis. Her vast experience has seen her lead the bank in debt acquisition, diversification of treasury products and growth of the bank's balance sheet size.

Maureen graduated with First Class Honors in Bachelor of Science in Information Technology, she also holds an MBA in Strategic Management and is ACI Certified. She has also attended a number of trainings including Aspire Leadership training at Strathmore School of Business, derivatives training courtesy of NSE and Dreadnought Capital South Africa Bloomberg, Reuters Proficiency Training and Thomson Reuters Seminar amongst others.



**Rose Kimani**  
Head of Retail Banking and Bancassurance

Rose is a seasoned Microfinance banker with over 25 years' experience in asset and liability growth as well as quality management. Rose has served in Faulu in various capacities.

She has grown from being a Credit officer to Branch Manager to Manager Business Development to Senior Business Development Manager to the Head of Business Development to the Head of Retail Banking and lastly to her current position.

Some of her achievements include; Pioneering the Check-off Lending and Automation of Bancassurance system in Faulu. She has been a key resource in the Faulu Transformation journey. Rose also prides herself in being a solid mentor and coach.

She holds a Master's degree in Social Dynamics and a Bachelor of Arts degree in Sociology.

Rose has been certified by the Frankfurt Business school on SME lending and attended Executive Leadership Trainings from Daystar and Strathmore University.

She is one of the privileged few who have won the prestigious award in Banking: The Life Achievement Award in Banking.

**Peter Iha**  
Head of Human Capital

Peter joined Faulu in November 2012 as Human Resource Manager, Branch Relations. He was promoted to Senior Manager Human Resource Business Relationship and is currently the Head of Human Capital at Faulu Microfinance Bank.

Peter is widely experienced in Human Resource Management and has 25 years' experience in the Banking Industry. Prior to joining Faulu, he was the Relationship Manager Retail at Co-operative bank.

He has spearheaded culture transformation in the bank through the successful implementation of training programs. Peter has also supported the leadership team in enforcing a high-performance culture in the organization which has resulted to a cohesive and high-performing team in the bank leading to an improvement in overall organizational effectiveness.

Peter has a master's degree in Human Resource Management, an MBA in Strategic Management, Bachelor of Commerce Accounting and Business Administration and a Diploma in Leadership Coaching.

**Michael Mutisya Kalii**  
Head of Operations and Customer Experience

Michael Mutisya Kalii Joined Faulu Microfinance Bank in 2016 as Head of Operations. He is currently in charge of the Banks Operations and Customer Experience. Michael has over 20 years working experience in Operations, Business and Transformation of payment solutions.

He previously worked at K-rep Bank (now Sidian Bank) and was in charge of different departments namely; Head of Business Development and Head of Operations and IT.

He is a seasoned banker and has a wealth of experience in micro-finance operations.

Mr. Kalii currently serves as a Member of the Senior Management Committee in Faulu, he is the Chairman of Matasia Parish, he serves in the Board Management of several schools and has previously served as Chair-K-rep Group provident Fund.

He holds a Bachelor's degree in Mathematics, a Diploma in Information System Management (IMIS) and a Master's in Business Administration (Operations Management) and lastly a Certificate in Trade Finance operations.



**Sheila W. Maina**  
Head of Legal Services

**David Mukaru**  
Head of Business Growth

Sheila joined Faulu in 2015 as a Legal Officer, she was later appointed the Legal Manager in 2017 and is currently the Head of Legal. She has the overall responsibility for the Bank's Legal Services and Legal Risk Management which includes legal advisory, company secretarial and corporate governance support, legal & regulatory compliance, securitization, litigation and contract portfolio management and operational support.

A seasoned legal practitioner and highly experienced in diverse areas of law, Sheila is passionate about creating her niche as a trusted corporate legal advisor.

Prior to joining the Bank, she was an associate at MMC-ASAFO Advocates, a top tier law firm in Kenya where she represented diverse clients including Banks, Statutory Bodies, listed corporate entities and private clients. She holds an LL.B (Hons.) from the University of Nairobi, is an Advocate of the High Court of Kenya, a Commissioner for Oaths and a member of the Legal Committee of Kenya Bankers Association. She holds certification in areas of Alternative Dispute Resolution, Business Continuity Management and Corporate Governance.

David is the Head of Business Growth at Faulu Microfinance bank. He previously worked as the General Manager in charge of Credit at Equity Bank, Tanzania subsidiary for six years. Previously, David worked as Head of Micro Credit for six years, in Equity Bank, Kenya; Operations Manager for three years, in Women Economic Empowerment Consort and as a Credit Officer at BIMAS and Kenya Industrial Estates.

He has over 27 years of experience in the field of Retail banking and Microfinance specializing in designing training programs, planning and implementation of innovative retail products and services.

David is a graduate of Business Administration from Kenya Methodist University and is currently pursuing a Post-graduate program at Strathmore specializing in Agribusiness management. He has also attended leadership programs from Wharton Business School and Boulder Microfinance training program.

**Enjoy Business Transactions in these currencies**

- The Euro
- South African Rand
- Great Britain Pound
- US Dollar

**Faulu**  
A MEMBER OF THE OLD MUTUAL GROUP



**DR. PETER WANYAGA MUTHOKA**  
Chairman

## ▶ Chairman's Statement

I am pleased to present to you the Faulu Microfinance Bank Limited (the "Bank") 2019 Annual Report and Financial Statements for the year ended 31st December 2019. The financial statements include the consolidated financial statements of the Bank and its subsidiary (together, the "Group").

This is yet another great year for the Bank as Bank continues to grow, a demonstration of the commitment by the Board of Directors, the management and the wider Faulu fraternity in ensuring that the bank not only delivers its set targets but provides relevant financial solutions to its customers.

In 2019, the bank continued to leverage on the upgraded T24 system which has continued to improve efficiencies and customer experience.

## Operating Environment

According to World Bank, the Kenyan economy is projected to have expanded by 5.7% in 2019, a slight decrease from the estimated 5.8% growth experienced in 2018. The slower growth was as result of slowdown in agricultural activities as a result of delayed long rains, which curtailed agricultural production and reduced government investment.

## Inflation and Interest Rates

Overall inflation stood at 5.82 % in December 2019, compared to 5.04% in December 2018, which is within the Central Bank of Kenya preferred range of 2.5% - 7.5%. The inflationary pressure witnessed was due to drought and bad weather conditions that affected food prices.

In the year, the Monetary Policy Committee reduced the Central Bank Rate in November 2019 by 50 bps to 8.5% from the earlier 9.0% that had been set in July 2018, citing that inflation expectations remained well anchored within the target range and that the economy was operating below its potential level.

The Kenyan Shilling gained 1.4% against the US Dollar to close at Ksh101.3 / USD in 2019 compared to Shs 101.8/USD at the end 2018. This was supported by inflows of hard currency from remittances by Kenyan workers abroad and offshore investors.

## Financial Results

During the year under review, Faulu bank posted pre-tax profits of Ksh 482 million up from Ksh 287 million in 2018. The major drivers of this improvement were from growth in interest income by 20%, growth in net non-interest income by 8% resulting from increased disbursements, embracing of alternative channels and lower operational and administrative expenses by 4% due to management's stringent cost containment measures.

The non-performing loans ratio improved from 13.07 % in December 2018 to 12.1% in December 2019. This was mainly attributed to proper underwriting and aggressive collection.

Total Bank assets grew by 9% from Shs 27.2 billion in December 2018 to Ksh 29.7 billion in

2019 driven mainly by the growth of the loan book by 10%. The gross loans and advances to customer increased from Ksh 20.2 billion in 2018 to Ksh 22.2 billion in 2019. The banks customer deposit grew by 8% from Ksh 18.5 billion to Ksh 20.1 billion in 2019.

## Developments in the Banking Sector

For the year ended 31st December 2019, the banking sector saw a number of developments as detailed below

### Interest rate cap appeal

The president signed into law the Finance Bill 2019 which repealed Section 33B of the Banking Act that provided for the capping of bank interest rates. This was a move by the Government to revive the shrinking credit access to the private sector. Banks are expected to act responsibly by enhancing pricing transparency and support enterprise development and the MSME sector through innovations. The rate capping led to low credit to micro, small and medium enterprises, shrinking of the loan book of the small banks and reduced financial intermediation. It also reduced the signalling effects of monetary policy

### Technology Leverage

The banking industry has moved deeper into financial technology space. There has been a need to leverage on technology to drive efficiencies in industry operations in order to serve customers better with relevant products that meet their expectations.

### Regulations

#### Impactful regulations in the industry included;

- IFRS 9-came to effect in January 2018, a new standard in loans provisioning, this has led to increased impairment allowance affecting the bank's profitability
- Demonetization – carried out to curb illicit flows. The exercise had little impact on inflation and banks experienced no influx of customers in exchanging the note. In some cases, the exercise tightened liquidity in the money market that prompted people to seek alternatives on digital platforms, which ultimately encouraged them to use digital banking platforms more, thus, increasing non-funded income from fees and commissions

- IFRS 16 - The initial application of IFRS 16, a new accounting lease standard, was introduced from 1 January 2019. The new lease accounting rules affect all sectors including banking and other industries. The impact is likely to be particularly severe for companies and sectors who are lessors of numerous or high value operating leases. IFRS 16 replaces the straight-line operating lease expense with a depreciation, charge on the Right of Use of Asset (reported under operating costs) and an interest expense on the lease liability (reported under finance costs) in the income statement. The depreciation charge is typically even, but the interest expense reduces over the life of the lease as lease payments are made

### Industry Non-Performing Loans (NPLS)

High Non-Performing Loans remains a challenge in the industry with Portfolio at Risk (PAR) averaging at 12%. With real estate, retail, and manufacturing as the major sectors contributing largely to the Non-performing Loans. The High NPLs were attributed to factors such as subdued business activities, delayed government payments and reduced spending power by consumers. Banks have stepped up debt recovery efforts and improved on credit scoring.

### Looking forward

Faulu key pillar is to become customer centric and improve on customer experience in order to grow all the Banks KPIs. We will leverage on innovation and digital technology to reduce operational cost and improve efficiencies. Mobile application platforms, automated credit scoring and internet banking capabilities are some of the measures that the bank will employ to increase collection of deposits and disbursement of loans.

Increase in customer touch points through rollout of agencies, mobile banking offering and diversification into different revenue streams will enhance customer experience.

Our focus will remain acquiring entry level customers as well as offering transformative products to Retail and Micro Small medium enterprises.

### Acknowledgement

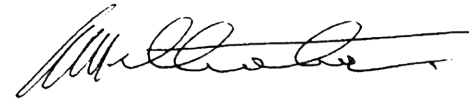
My appreciation goes to our clients for making Faulu their financial partner.

I appreciate our business partners for their continued support throughout the year.

I would like to appreciate my fellow directors for continuously providing strategic and expert direction. Additionally, I convey my appreciation to the management and staff for their hard work and dedication during the year.

Lastly, I thank the Government of Kenya and the regulatory authorities namely: Central Bank of Kenya and Kenya Revenue Authority who continue to provide an enabling business environment that fosters growth in the financial industry.

Thank you and God Bless You.



**Dr. Peter Wanyaga Muthoka**

**D.ML, M.A (Ed.) B.A (Hons), EBS, MBS, FKIB, FKIM, DID  
Chairman**



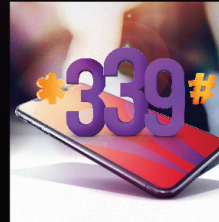
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\*Terms and conditions apply.



## KARIBU

TO THE BANK THAT UNDERSTANDS YOUR NEEDS.

# Faulu

A MEMBER OF THE OLDMUTUAL GROUP



**APOLLO N. NJOROGÉ**  
Faulu Kenya - MD

## ► Managing Director's Statement

2019 was a great year for the Bank, and it is with great pleasure that I present the Annual Report and Financial Statements for Faulu Microfinance Bank for the year ended 31st December 2019.

The 2019 bank's performance broke the profitability record of Kshs.432M set in 2014 and indeed, we succeeded in Making Faulu Great Again by posting a profitability Kshs.482M!

### **2019 MILESTONES**

Some important milestones that were achieved 2019 were:

1. Breaking the profitability record of Kshs. 432M set in 2014 by achieving a profitability of Kshs.482M.
2. The Bank hit Kshs.21Billion mark in loans and advances to customers.
3. The Bank reached Kshs. 20Billion mark in customer deposits.

## Performance Summary

4. The Bank won several awards which include:

- The Best Microfinance Bank in Kenya -Think Business Award
- Best Microfinance Bank in Financial Reporting (FiRe award)
- Best Microfinance Bank in Real Estate Financing
- Most Preferred Microfinance Bank in Automotive Financing
- Best Microfinance Bank in Digital Tech Solutions
- SME of the year award in Corporate Citizenship and Environmental Focus
- Winner in Financial Management -SMOYA Award.

5. The Bank opened three Branches in Ugunja, Kapenguria and Voi.

6. Launch of customer experience training curriculum and product handbook training bank-wide to entrench a customer centric culture in bank.

As a Customer Centric organization, our focus is to grow our Current and Savings accounts - CASA by improving the quality of relationships we have with our clients.

Through this the bank will be able to achieve its ambition of becoming the leading Retail and MSME Bank and Bancassurance Champion.

The profit before tax recorded in 2019 was **Kshs. 482 Million** this performance went up by 76% as compared to 2018 when the bank recorded a Profitability of Kshs 287Million driven by the following factors:

### Interest income

▲ **20%**

Increased to Kshs. **4.9 Billion** driven by growth in loan and advances to customers

### Non-interest income

▲ **8%**

as a result of embracing alternative channels, with the bank onboarding new **483 agents** in the year to support agency banking

### Operating expenses

▲ **Kshs. 2.1 Bn**

were lower by **4%** due to management's stringent cost containment measures.

### Interest expense

▲ **Kshs. 2.3 Bn**

increased minimally by **9%** following proactive balance sheet management and growth in customer deposits

### Credit Impairment

▲ **Kshs. 562 Mn**

up from **Kshs 109 million**

### Banks Portfolio at Risk (PAR)

▲ **12.09%** in 2019

improved from **13.07%** attained in 2018

The management continues to focus on high quality underwriting and aggressive collections to maintain a quality book.

## Balance Sheet and Liquidity

The bank's balance sheet closed at Kshs. 29.7 billion up by 9%. compared to Kshs. 27.2 billion in 2018. Gross loans and advances to customers increased by 10% to Kshs 21 billion. Customer deposits were up by 8% to reach 20 billion majorly driven by aggressive marketing campaigns and Current Accounts & Savings Accounts (CASA) drive initiative.

The Liquidity ratio closed at 26% on account of increased customer deposits.

## Capital Base and ratios

The bank's capital position remains strong with all metrics above the regulatory thresholds. The core capital to risk weighted ratio of 15.5 % lower than prior year of 16.9% driven by higher profits and high-risk weighted assets.

## Outlook

As we Journey to the Top this 2020, we will remain focussed on relationship management, growth of customers, deposits, asset book, non-interest income and reduction of the impact of portfolio at risk through proper underwriting, continuous collections and proactively managing spill overs, embrace Foreign Exchange (FX) and promote usage of our channels.

## Acknowledgment

I thank all our clients for their support, taking Faulu as their Bank of choice and our development partners and lenders who not only provided funding but also supported the institution with technical assistance programs that have created significant leadership bandwidth for growth.

I take this opportunity to extend sincere appreciation to all staff for their great commitment, diligent effort and enthusiasm in delivering impressive results during the year and value to our customers and shareholders.

I wish to appreciate the Board of Directors for having provided invaluable guidance to the bank. I look forward to your support in making 2020 even better.

Thank you and God bless you.



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**Apollo N. Njoroge**  
Managing Director



Think Business  
Award Winner

★ ★ ★  
— OVERALL —  
**BEST**  
**MICRO**  
**FINANCE**  
BANK IN KENYA



**Think BUSINESS** BANKING AWARDS 2019  
Faulu Microfinance Bank  
Overall Best Micro-Finance  
Bank in Kenya 2019  
Winner

**Think BUSINESS** BANKING AWARDS 2019  
ROSE KIMANI  
Lifetime achievement award in Banking  
Winner

**Think BUSINESS** BANKING AWARDS 2019  
Faulu Microfinance Bank  
Overall Best Micro-Finance  
Bank in Kenya 2019  
Winner

**Think BUSINESS** BANKING AWARDS 2019  
Faulu Microfinance Bank  
Best MF Bank in Agriculture and  
Livestock Financing  
1<sup>st</sup> Runners Up

**Think BUSINESS** BANKING AWARDS 2019  
Faulu Microfinance Bank  
Best Bank in Product Marketing  
2<sup>nd</sup> Runners Up



## Our Sustainability Review

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- ▶ **Our sustainability agenda is to enhance financial inclusion and help Kenyans achieve their ambitions by fulfilling their financial needs in a responsible and sustainable manner.**

We enable people, businesses and society to grow progressively and sustainably in the long-term.

As a member of the Old Mutual Group, part of our commitment to Social responsibility is to actively support our company-wide global strategy. Responsible business practices are core components of the Old Mutual Group risk management strategy which is underpinned by the Group's four values of: Integrity, Respect, Accountability and Pushing beyond boundaries.

By managing our finances responsibly, we build trust and strong, profitable relationships. We also achieve great success by upholding responsible business.

Our sustainability approach aims to balance Social, Economic, Environmental Risks and Opportunities through the deliberate use of our products and services, collaboration and partnerships and by managing our own impact.



## ECONOMIC



### Local Economic Impact

Credit is the fuel of the economic engine. Over the last five years, our net loans and advances to customers grew at a Compounded Annual Growth Rate (CAGR) of 5.7%; as at December 2019, to **Kshs.21.1Billion** from **Kshs.16.9 Billion** in 2015 which was a recognisable performance as net loans and advances to public and private enterprises took a surge.

As the **leading microfinance bank in profitability and deposits in 2019**, we pride ourselves in offering financial transformation through provision of financial education and integrated financial services that includes Banking, Savings, Investments and Insurance solutions through our various channels which comprise: mobile banking, Visa Cards, and through our Agents spread countrywide.

Our Accolades Include:

- Think Business Award 2016 as the fastest growing Microfinance Bank
- The Best Microfinance Bank in Kenya -Think Business Award 2019
- 6 Wins of the Best Microfinance Bank in Financial Reporting (FiRe award)
- Best Microfinance Bank in Real Estate Financing
- Most Preferred Microfinance bank in Automotive Financing
- Best Microfinance Bank in Digital Tech Solutions
- SME of the year award in Corporate Citizenship and Environmental Focus
- Winner in Financial Management -SMOYA Award
- Top Employer Award

Faulu has over **300** service providers and Ten (10) Foreign Service providers. In 2019, the bank paid **over Kshs. 894 million** to our suppliers with 90% of the total revenue paid to local suppliers.

The following policies and manuals guide procurement and Facilities management;

- Procurement and Facilities Management Manual,
- Procurement and Facilities Management Policy,
- Risk Policy,
- Accounting Manual & Operations Manual.

### Through Partnerships:

Development finance is required for long-term investment and economic growth. We had long term borrowing of up to Kshs4.3 Billion.

### Taxes

We contribute to the creation of prosperity and to the stability of our country by remitting our taxes on time.

Taxes provide essential public revenues for governments to meet economic and social objectives. We view taxation as a mainstream part of our corporate social responsibilities. Faulu is also KRA's appointed agent to assist the taxman in collection of various taxes across the country.

## Social Sustainability Initiatives

### Employee Welfare

We are determined to make Faulu a great place to work and we therefore encourage staff to bring out the best in themselves at work and by helping one another realize their full potential. We view one another as part of one big family, and each member's welfare as our collective responsibility.

Our Staff welfare club participates and contributes to the welfare of the members in times of need and during celebrations. We stand with one another when we:

- Welcome newborns
- Celebrate marriages or weddings and
- When our staff are hospitalized
- When our staff are bereaved.

We invest in out-of-office staff activities such as sports events, team building and Corporate Social Responsibilities to help staff reflect and bond.

In 2019 we introduced Table Tennis sport for staff to unwind and socialize during lunch breaks.

Our staff engagement initiatives in 2019 were:

**Purposeful Casual Fridays:** During this day staff are challenged to follow a dress theme in support of a social cause.

**Staff wellness** is aimed at encouraging a healthy lifestyle. Some of the activities realised in the year included annual free medical check-up, a motivation for staff to embrace the Go Plus App to ensure staff stay healthy and at the same time earn points which can earn them awards like shopping vouchers from time to time.

**Get Motivated to Prosper** was an Faulu Old Mutual Womens' Network (OWN - EA) initiative done to motivate the women in the workplace to work best in order to achieve their goals. On this day a panel of renown ladies took time to speak to the women about their life journey and encourage them to be their exceptional best.

### HR Policies Framework

We have proactive HR Policies, procedures and manuals that guide us on HR related issues. These include:

- Disciplinary, Grievance Policy and Procedures
- Sexual Harassment Policy
- HIV/Aids Policy
- Occupational Health & Safety Policy
- Code of Conduct & Ethics
- Loan Policy
- Whistle blowing policy
- Leave policy
- Promotion policy
- Recruitment policy
- Performance Management policy
- Performance Improvement Policy
- Dress Code Policy
- On job training procedure and work rotation policy

### Whistle-blowing Policy

The Whistleblowing policy is intended to encourage and enable employees to raise serious concerns within the bank rather than overlooking a problem or simply reporting it outside of the defined channels within the Bank.

The policy provides avenues for staff to raise concerns and receive feedback on any action taken.

Reassure staff that they are protected from reprisals or victimization for "whistleblowing" in good faith.

The policy provides that staff may report an issue if it is unlawful; fraudulent; contrary to the bank's policies and procedures; falls below established standards of practice; amounts to improper conduct and breach the Bank's code of Conduct.

The bank has put in place systems to encourage staff to raise concerns in a structured and protected way. The bank respects the confidentiality of staff raising concerns and sets out arrangements that include the opportunity to raise concerns outside the management structure.

### Labour Standards

We appreciate the need for work-life balance for our staff and we have created an inclusive and conducive environment to cater for their different requirements. We support staff in child-rearing responsibilities by providing time off work for male and female staff in line with existing labour laws and best practice for enhanced productivity and employee engagement.

The bank has a designated mothers room equipped with the necessary facilities to support mothers after their maternity leave.

The bank maintains cordial relations with the staff union and we continue to foster partnership to ensure that staff interests are addressed on time. There is a Collective Bargaining Agreement that provides guidelines on the management and policies around the unionised employees.

### Environmental Sustainability Initiatives

As part of improving the way we manage our direct environmental impacts we have developed an environmental sustainability programme that revolves around reforestation and seeks to ensure we conserve our environment by increasing forest cover as well as keeping the environment around us clean. This has led the bank to organise for tree planting days and clean up days every year.

The bank through the staff has actively participated in tree planting activities over the years at the slopes of Ndakaini in Ndeka and at Aberdares National Park and Kireita Forest.

A summary of our **Responsible Business Agenda and Goals** are:



#### 01/ Responsible to our customers

We treat our customers fairly, equipping them with financing skills and develop products that meet the needs of our customers. This ensures that they access affordable and transparent financial services.



#### 02/ Responsible investment

We ensure our investments, work practices and buildings are geared towards reducing our direct and indirect impact on the environment.



#### 03/ Responsible to our employees

We ensure we treat our employees fairly, meeting their needs as our internal customers and community members, and giving them an opportunity to give back to society. The Bank does this by:

- Promoting equality in the workplace
- Developing talent to be future fit



#### 04/ Responsible to our communities

We work with our community and other partners to build a better world-contributing to education, skills development and local economic development.



#### 05/ Responsible environment management

We ensure our investments, work practices are geared towards reducing our direct and indirect impact on the environment. Faulu does this by:

- Promoting access to education and health care in the communities we serve
- Conserving the environment and driving sustainable consumption of natural resources

Faulu bank has come up with strategic initiatives for staff engagement which have continued to be instrumental in ensuring that the company is a great place to work and learn while developing a workforce that can deliver the banks long term strategy. For this to be brought to life staff engagement activities have been embedded in the company's strategic goals.

Below are some of the staff engagement initiatives undertaken in 2019: -

**The Faulu Old Mutual Women's Network Kenya (OWN)** organized a Motivational talk session to motivate and inspire women to work relentlessly towards achieving their dreams. The talk show was spearheaded by renowned ladies in the corporate world who have managed to achieve high goals and climbed the career ladder. Some of the ladies leading the motivational talk session were Faulu Board Directors, Departmental Heads in the bank as well as invited guests. They took time to motivate the women to keep working hard and not give up on their goals because they are a true testament that aspirations can be met with right attitude and effort.



## Our Staff Engagement Activities

Front Row, R-L: Grace Thiong'o (Faulu Lead-OWN), Nkirote Njiru (Patron-OWN, E.A.), Guest speaker: Carol Mulwa (Investment Manager, East & Southern Africa at Oiko Credit).

UAP Old Mutual and Faulu staff at Kireita forest ready for the Forest Challenge and Tree planting

- ▶ **UAP Old Mutual marked Old Mutual's 174th Birthday** through various initiatives; employees showcased their diversity through dressing up in various cultural attire represented in the East African community and supporting a good cause in the various communities they operate in.

**Health and wellness programs including periodic health checkups** was done for staff to understand their wellbeing in order to choose a healthier lifestyle. The wellness programs have immense benefits which include; improving staff productivity, reduce risk of diseases, reduce stress, makes staff feel more energized and engaged, decrease absenteeism, improve employee morale, break monotony and in return the company creates a positive image and a great workplace culture, a culture of health. The benefits are endless and once employees are engaged, they love and enjoy work.



**Staff engagement surveys** were conducted by the Human Capital Department and all staff were called upon to participate. Respective feedback sessions were held based on the survey reports to improve on the weak areas of business and to improve the work place culture.

**Leadership Town halls** and caravans we conducted around the country to analyse the business performance in different regions and for staff to relay feedback. Thus improve the relationship between management and staff in order for the business to ensure that all staff are aligned towards one goal for the business.

▼ *Faulu MD, Apollo Njoroge addressing staff at one of the Town Halls*



▼ *Happy during the launch of the Customer Experience Curriculum*



▲ *Faulu Head of Audit, Paul Kahoro shares scripture teaching with staff*



▲ *Staff at the Town hall listening keenly*

▼ A well-attended Wide area meeting



### Faulu bank held two Wide Area Management Meetings (WAMM) to

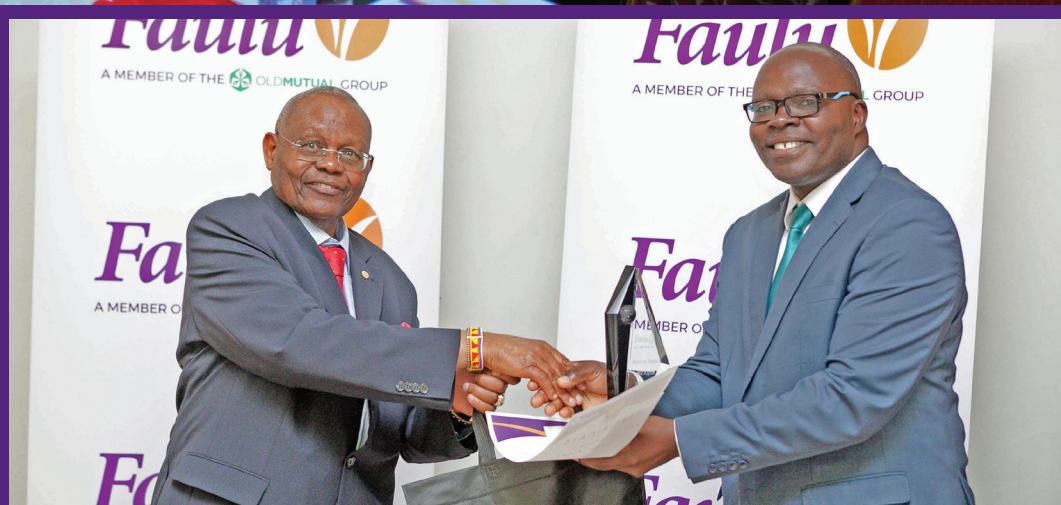
share the bank's strategy and plan for a successful year. The meetings which brought together all Managers nationwide and were held to appreciate good performance from staff and the branches, to share ideas and learn from one another to ensure a balanced performance from all branches and departments across the bank.

▼ Leaders keenly listening



▲ Faulu Board Director, George Maina, awards Thomas Ogallo - Branch Manager Kisumu for stopping a fraud through whistleblowing

Faulu Board Chairman Dr. Peter W. Muthoka awards the top performing region for exemplary performance ▶





### Talent Development

Periodic talent development initiatives were rolled out to sharpen employee's skills. These included Leadership Development both for Middle and Senior Management, Coaching & Mentorship and technical trainings for staff.

The middle level managers and high performing staff were provided with the opportunity to attend leadership programs at the Strathmore university – (**Aspire leadership program**)

- ▲ UAP Old Mutual and Faulu leaders as well as Top performing staff graduate after completing Aspire Leadership training at Strathmore School of Business

## Our Staff Customer Engagement Activities

The bank opened branches in **Voi, Ugunja, Kapenguria** and a Marketing office in **Taveta** in the year 2019. Faulu's physical presence in the above counties is a clear signal that the bank is ready to walk with its customers to enable them access convenient financial services at a one stop.

**Faulu launched Agency banking in Murang'a County** in order to offer superior services to its esteemed customers in the county and country at large. Faulu is also the first Microfinance Bank to launch Agency Banking and has so far recruited over 500 Agents countrywide.



▲ Faulu team at the Voi Branch Launch



▲ Faulu Officially Launches Agency banking in Murang'a



▲ Voi Branch Launch



▲ Ugunja Branch Launch



▲ Kapenguria Branch Launch



## Partnerships

- ▶ **Faulu signed an agreement with the Feed the Future Kenya Crops & Dairy Market Systems Activity (KCDMS),** a USAID funded program, to extend tailored financial services to farmers in Busia and Homa Bay Counties. The partnership was commenced to benefit at least 10,000 farmers in both counties within three years.

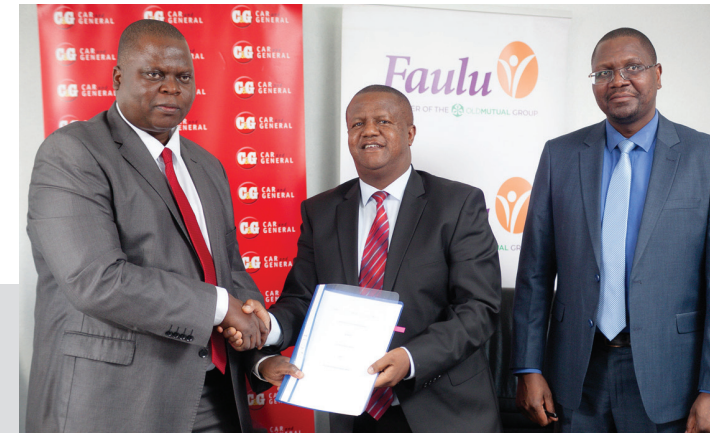
To hit this target, Faulu Kenya is working with farmer groups, with each group having between 30 and 50 farmers. The bank aims to recruit 100 groups annually over the three-year life cycle of the project.

Under the partnership, farmers will also benefit from training, capacity building and market access.

- ▶ **As part of its strategy, Faulu Bank inked a deal with Car and General as well as Bajaj that will enable its customers in the transport business to acquire below market rate priced motorcycles.**

Under the deal, Faulu customers mainly organized in SACCOs will benefit from an innovative solution that includes affordable financing, insurance and the installation of tracking or anti-theft devices on their motorcycles.

According to the Motorcycle Assemblers Association of Kenya (MAAK), there are about 600,000 commercial motorcycles currently operating in Kenya, each earning an average of Sh 1,000 a day which translates to an annual turnover of Ksh. 219 billion. The industry is one of the biggest drivers of the economy.



▲ *Left: Car and General Trading Kenya MD, Mr. David Chesoni and Faulu MD, Apollo Njoroge (middle) sign a partnership deal*

## Our Corporate Social Responsibilities

### The UAP Old Mutual Foundation Summary of Activities;

#### Environment

**70,000**  
Total number  
of trees planted

#### Counties Covered in tree planting initiatives:

- Nyeri
- Murang'a
- Kiambu
- Kisii
- Kajiado
- Homa Bay



#### Healthcare



Mama Lucy Kibaki Hospital  
Queue Management System  
Installation

**365,000**  
Patients annually

Kenyatta National Hospital  
A&E Wing Renovation  
to serve

**180,000**  
Patients annually

Uasin Gishu District Hospital  
Maternity &  
Lab Renovation

**108,000**  
Patients annually

Al Sabah Children's Hospital  
Renovation:  
Improved services for

**11,000** Admissions &  
**23,000** Outpatient visits

#### Education



#### Scholarships in:

- Gatanga, Sunshine School,
- Starehe Boys Centre,
- Starehe Girls Centre,
- Brookhill Academy

Provision of Assistive Devices  
for Special Schools in

**5 counties**  
Bomet, Kitui, Meru,  
Kisumu & Likoni



Provision of Financial  
Education for over

**10,000**  
participants since  
2016 to date



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CASHLESS**

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## Faulu Corporate Social Responsibilities

- ▶ Being there for the community we operate in:

### INVESTING IN HEALTHCARE

UAP Old Mutual and Faulu Foundation, the social investment arm of UAP Old Mutual Group partnered with organizations to support initiatives that improve access to quality healthcare through the improvement of medical infrastructure and intervention programmes. In 2019 the Foundation supported the community in the two areas by:

#### 1. Improving efficiency at the Mama Lucy Kibaki Hospital

Mama Lucy Kibaki Hospital serves over one thousand (1,000) patients received daily from the Eastlands area of Nairobi and its environs. As a result of the many patients received daily, the long waiting times and queues are a common phenomenon at the hospital as commonly seen in various public outpatient facilities across the country. This challenge has contributed to a range of public health issues including impaired access to health care at the public facilities.

Through the installation of a **Queue Management System (QMS)** by the UAP Old Mutual Faulu Foundation, the hospital has improved its management of patients and upgraded their reporting measures.

How the Queue Management System works (Operating the Ticketing system):

- A patient arrives at the outpatient wing of the hospital and receives a ticket number then he/ she proceeds to the waiting area
- The ticket is then prompted on the screens as well as on the speakers mounted at different service points
- The patient then proceeds to receive service while the ticket number is transferred to the subsequent points of care such as registration, triage, consultation, specialty clinics, cash office and pharmacy.

In addition, the Foundation provided **120 patients' benches** for the comfort of patients seeking treatment

The sponsorship of Mama Lucy Kibaki Hospital was **worth Kshs. 5 Million** and is the fourth of its kind in UAP Old Mutual Group healthcare initiatives. Other upgraded hospitals in the county include; Kenyatta National Hospital and Uasin Gishu County Hospital.



▲ Faulu Chairman, Dr. Peter W. Muthoka and Nairobi Governor, Mike Sonko officiate the use of the Installed Queue Management system at Mama Lucy Hospital



▲ A tour of Mama Lucy Hospital by the UAP Old Mutual Faulu Foundation



▲ A group photo of the UAP Old Mutual Faulu Foundation leaders, leaders from County Government and Mama Lucy Hospital

## 2. Free Medical Camps

In 2019, the Foundation sponsored screening for 3000 people in Meru, Bungoma and Taita Taveta Counties. The initiatives focused on prostate, cervical, breast and eye screening, as well as treatment for general ailments such as waterborne diseases at an investment of Kshs 4.5 Million.



## EDUCATION

The Foundation continues to provide scholarships for students to access quality education. 2019 saw 2 students complete their undergraduate and Secondary studies at University of Nairobi and Sunshine Secondary School respectively.

Other beneficiary schools previously supported were Gatanga Secondary and Starehe School.

## CONSERVING THE ENVIRONMENT

- ▶ UAP Old Mutual Faulu Foundation supports initiatives that promote environmental conservation through funding of sustainable management of resources, the protection of the natural environment through changes in public policy, individual behavior and conservation initiatives to combat climate change as well as increase access to clean water.

Through partnership with East African Wildlife Society, UAP Old Mutual staff participated in the Forest challenge which raises awareness on the importance of forests and the danger of deforestation. The UAP Old Mutual Foundation donated 4,000 tree seedlings to the initiative. Prior to this, 400 seedlings were purchased by staff during the Global Tree Planting Awareness Day in partnership with Miti Alliance. Additionally, the Foundation donated 1,400 and 1,520 trees to staff initiatives Kitengela and Kisii respectively.

The Foundation's tree planting agenda is aligned to the National target to achieve 10% tree cover by 2022. In its 5 years of existence, the Foundation has sponsored planting of 70,000 tree seedlings in Nyeri, Murang'a, Kisii, Homabay, Kajiado and Kiambu Counties.



▲ The UAP old Mutual Group CEO (middle) smiles as he plants a tree at Kireita Forest



▲ Mr. Joshua Muiru, Faulu Board Director, Faulu MD, Apollo Njoroge with Faulu team at the tree planting event in Homabay County

—  
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—



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- ▶ The directors present their report together with the audited financial statements (the “company” or Bank” or “Faulu”) and its subsidiary (together, the “Group”) for the year ended 31 December 2019, which disclose its state of affairs in accordance with the Kenyan Companies Act, 2015 and Microfinance Act, 2006.

### PRINCIPAL ACTIVITIES

The principal activity of the Bank is the transformation of lives through the provision of loans to micro and small entrepreneurs and deposit taking from the public.

### OPERATING RESULTS FOR THE YEAR

	Group		Bank	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Profit before tax	482,419	287,360	456,472	273,615
Taxation charge	(152,288)	(96,916)	(144,509)	(92,709)
Profit for the year transferred to retained earnings	330,131	190,444	311,963	180,906

# REPORT OF THE DIRECTORS



## BUSINESS REVIEW

### Operating Environment

The average inflation for year 2019 was 5.8% up from inflation rate of 5.04 % that was experienced the previous year.

Kenya has made significant political, structural and economic reforms that have largely driven sustained economic growth, social development and political gains over the past decade. However, it's key development challenges still include poverty, inequality, climate change and the vulnerability of the economy to internal and external shocks. A stable macroeconomic environment, low oil prices, rebound in tourism, strong remittance inflows, has boosted the economic expansion and a government led infrastructure development initiative.

According to the World Bank's Kenya Economic Update, medium-term gross domestic product growth (GDP) is expected to rise to 5.9% in 2020 and 6.0% in 2021 underpinned by private consumption, a pick-up in industrial activity and still strong performance in the services sector. Inflation is expected to remain within the government's target range while the current account deficit is projected to remain manageable. Growth will also be driven by ongoing key investments to support implementation of the Big 4 development agenda and improved business sentiment. Growth could have been stronger in the absence of interest rate caps that continue to derail recovery in private credit growth.

**Mergers and Acquisitions:** In 2019 saw major consolidation witnessed in the industry and further alliances are expected to create stronger players in the industry though with negative effects such as job losses. NIC and CBA bank merged to form NCBA while Kenya Commercial Bank (KCB) acquired National Bank Kenya (NBK). There are announced acquisitions – with Commercial International Bank - Egypt proposition to acquire Mayfair Bank, Access Bank Nigeria set to acquire Transnational bank.

**Rebranding:** Several banks rebranded to capture more market share by improving their public image and to better position their brands.

CBA and NIC Bank merger, gave birth to NCBA Bank who amended their logo and plans to streamline its services to position themselves in the industry for their target market.

ABSA – began rebranding from Barclays. The process of rebrand and repositioning began in

2018 and saw the bank rename all the subsidiaries in Africa realigning to their mother bank in South Africa. The new identity is meant to show the banks' scalability in Africa and reflect its strategy of being forward-looking

Equity Bank rebranded to Equity in a bid to present itself as a unified brand, with one basket of products and services under one roof – ranging from banking to insurance and investments across Africa.

The performance of the Group has been detailed in the Chairman's Statement.

### Market Description and Branch Networks

The Bank has 52 banking branches, 11 marketing offices and 533 appointed agents. These hubs and branches currently serve close to 480,000 customers. The bulk of the Bank's customers are civil servants while others are engaged in commercial activity of a retail nature, with a reasonable number engaged in service businesses, agriculture and manufacturing. The Bank did not close any banking branches but opened three additional branches.

### Products and Services

Faulu has a wide array of innovative products and services that meet our customer needs. The products and services range from savings accounts, term accounts, loans as well as insurance products.

### Risk Management

The Bank has put in place a robust risk management and corporate governance framework that enables it to identify, assess and prioritize its risks, as well as detail the mitigation and response plans for each category of risk. The year ended 31st December 2019 was characterized by a tough operating environment characterized by reduced GDP growth and reduced credit or liquidity to the private sector. The Bank will continue to monitor all risks affecting its business to ensure appropriate actions are taken to reduce potential impact.

Refer to note 3 of the financial statements for a description of the Bank's financial risks and how they are mitigated.

### Conclusion

We are optimistic that the operating environment will improve in 2020 as we continue to deliver impressive profit growth, anchored on our balance sheet strength and launch of digital platform. The impressive growth on all fronts is supported by robust foundation over the years, and it is upon this solid foundation that we launch into 2020 with great excitement.

## DIVIDEND

The directors do not recommend the payment of a dividend in respect of the year (2018: Shs nil).

## DIRECTORS

The directors who held office during the year and up to the date of approval of these financial statements are disclosed on page 2.

## AUDITORS

The auditors, Deloitte & Touche, having expressed their willingness, continue in office in accordance with the Kenyan Companies Act, 2015 and subject to approval by the Central Bank of Kenya under section 29(1) of the Kenyan Microfinance Act (2006). The directors monitor the effectiveness, objectively and independence of the auditor. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders,

## DIRECTORS' STATEMENT AS TO THE INFORMATION GIVEN TO THE AUDITORS

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information

BY ORDER OF THE BOARD



Nkirote K. Mworira  
Secretary  
Nairobi

4th March 2020





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Award Winner



Digital Inclusion Awards  
**WINNER**  
**BEST MICROFINANCE IN THE USE OF  
DIGITAL SOLUTIONS**

## Corporate Governance Statement

- ▶ **Faulu Microfinance Bank Limited received its Deposit Taking License from the Central Bank of Kenya on 21 May 2009, becoming the first institution in Kenya to be licensed to receive deposits from the public under the Micro Finance Act (2006). The Board of Directors of Faulu is responsible for ensuring that Faulu complies with the Laws of Kenya and the prudential guidelines issued by the Central Bank of Kenya.**

The Board of Directors of Faulu Microfinance Bank Limited is also responsible for ensuring that the Bank complies with the highest standards of corporate governance and universally accepted business ethics. The Board has developed, adopted and benchmarked a framework of internationally recognized principles of good corporate governance, which it endeavours to adhere to in the pursuit and maintenance of the highest possible standards.

The Board of Faulu further upholds the values of uncompromised integrity, while conforming to the highest standards of ethics, honesty, trust, fairness, quality and pursuit for excellence.

### Board size, composition and appointments

The Board comprises a balanced mix of proficient individuals. This takes into account a balance of executive, non-executive and independent Directors, various skills and competencies, differing experiences and team roles, balance gender and age factors. This ensures ability to add value while ensuring that there is an appropriate balance of power on the Board such that no individuals/interests has unfettered power or can dominate the Board decision making process.

There is a formal and transparent process for all appointments to the Board. On an annual basis, the Board reviews and assesses the composition and performance of the Board to ensure that:

- (a) the mix of membership is appropriate and compatible with the requirements of both the Board and the company;
- (b) Non-executive Directors commit adequate time and contribute effectively to the Board.

The Board is directly involved in the sourcing and appointment of new Directors and appointments are based on merit and against objective criteria.

### Board responsibilities

The Board is responsible for setting the direction of the company, corporate values and standards, and ensures that its obligations to shareholders are understood and met. In particular, their responsibilities include the following:

- Providing entrepreneurial leadership to the company within a framework of prudent and effective controls which enable risk to be assessed and managed;
- Strategy formulation (including company vision, mission and values) and ensuring that there are adequate policies, systems and structures to successfully implement the company's strategies;
- Elaborating duty of care and confidentiality, including establishing responsibility and obligations of individual Board members;
- Reviewing and approving the strategic plans and annual budgets, financial statements; and
- Monitoring the company's performance against strategic plans and objectives on an ongoing basis, as well as through mandatory quarterly meetings



### Chairman and Managing Director

The roles and responsibilities of the Chairman of the Board and the Managing Director remain distinct and separate. The Chairman provides overall leadership to the Board without limiting the principles of collective responsibility for Board decisions. The Managing Director is responsible to the Board and takes responsibility for the effective and efficient running of the institution on a day-to-day basis.

### Board Committees

The committees of the Board consist of a balanced mix of non-executive and executive Directors. The Board has constituted the following 5 main Board committees:

1. The Audit Committee
2. The Risk and Compliance Committee
3. The Credit Committee
4. The Governance Remuneration and Nominating Committee
5. The Innovations and Technology Committee (formerly- IT Committee)

Other ad hoc committees are set up as and when the need arises. The committees regularly reports to the Board on their activities and decisions.

### Board and Board Committee Meetings

The Board and its committees meet regularly in accordance with business requirements. Adequate notice was given for each meeting and directors received in good time detailed papers on the issues to be discussed. The Board and Board committees attendance during the year was as follows:

Board of Directors attendance	
Dr. Peter W. Muthoka	75%
George A. Maina	100%
Dr Catherine N. Kimura	100%
Sophia Mukoba	75%
Joshua Muiru	100%
Peter J. Mogan	100%
Peter K. Mwangi	100%
Peter Gachuba	100%
Apollo Njoroge	100%
Andre Keller	100%

### Board Sub-committees

#### Risk and Compliance Committee

George Maina	100%
Peter K. Mwangi	25%
Joshua Muiru	100%

#### Audit Committee

Joshua Muiru	100%
Sophia Mukoba	100%
Peter Mogan	66%

#### Governance, Remuneration and Nominating Committee

Dr. Peter W. Muthoka	100%
George Maina	100%
Peter K Mwangi	50%

#### Credit Committee

Peter Gachuba	100%
Dr. Catherine N. Kimura	75%
Andre Keller	100%

#### Innovations and Technology Committee

George Maina	100%
Joshua Muiru	100%
Peter Gachuba	100%
Apollo Njoroge	100%
Dr. Catherine Kimura	100%

### The Audit Committee

The Audit Committee has been established by the Board to assist in raising the standards of corporate governance and internal controls in the following areas:

- (a) Assisting the board in oversight of preparation and presentation of Financial Statements;
- (b) Recommending and reviewing adherences to accounting policies and internal controls;
- (c) Assisting the Board in ensuring the company's compliance with applicable laws and regulations as well as the company's charter, by laws and other internal regulations;
- (d) Acting as Board's central coordination point for investigation of complaints relating to financial statements, compliance, and internal controls; and
- (e) Oversee independence of external auditors.

### The Risk and Compliance Committee

The committee currently comprises of two Board members and has been established by the board to assist in the following responsibilities:

- (a) Establishing the company's risk policies, including risk tolerances, consistent with the Risk Management Program and ensuring that senior management takes steps necessary to identify, measure, monitor and control risk;
- (b) Reviewing the adequacy of the company's capital and allocations to various business units considering the types and sizes of risks at those business units; and
- (c) Establishing an enterprise-wide risk management framework for all functions in the company and at all levels.

### The Credit Committee

The Committee is a Board Committee established by and among the Board of Directors to assist in discharging their corporate governance duties by:

- (a) Reviewing and recommending for approval of the Board policies with respect to credit risk of the Bank's operations;
- (b) Reviewing and monitoring the application and effectiveness of such policies;
- (c) Review lending practices and quality of loan portfolio;
- (d) Ensure that there are effective procedures and adequate resources to identify and mitigate credit risk;
- (e) Monitor and evaluate all issues that may materially impact on the present and future quality of the loan portfolio and credit risk management;

- (f) Delegate and review lending limits to the sanctioning arms of the institution; and
- (g) Ensure adequate provisions for loans and advances, bad and doubtful debts and write off policy.

### The Governance, Remuneration and Nominating Committee

The committee has been established to assist the board with the following responsibilities:

- (a) Guiding and directing the implementation of remuneration strategy, policies, group-wide remuneration principles, related proposals and structure, whilst taking into consideration local conditions; and
- (b) Monitoring and controlling the remuneration and benefit structures and their costs.

### The Innovation and Technology Committee

The Innovation and Technology Committee (IT) was established by the Board of the Bank as part of its mandate to drive transformation, governance and business growth for the bank. The committee's mandate includes the following:

1. Develop and sustain the IT plan for the Bank and ensure approval by the Board. This include:
  - (a) Responsibility of managing strategic IT related projects like the core banking upgrade/ replacement; and
  - (b) Coordinating components of the IT plans from all units across the Bank;
2. Develop and recommend the Bank's IT policy;
3. Review and recommend IT project development plans in the context of IT strategic and transformation agenda;
4. Create ad hoc committees to address strategic ICT issues, when required; and
5. Review, coordinate and arbitrate major ICT activities across the Bank
6. Provide an update to the Board, Regulators and the relevant Old Mutual board on the progress made in the identified IT strategic projects and the transformation agenda.

### Management Committees

#### i) The Assets and Liabilities Management Committee (ALCO)

This committee meets every month or more frequently when necessary. ALCO, a risk management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposit withdrawals can be met as and when they fall due, and the company does not encounter difficulties in meeting its obligations or financial liabilities as they fall due. This includes management of operational risks, interest rate, market and exchange rate risks and ensuring compliance with statutory requirements governing liquidity.

## ii) The Management Credit Risk Committee

This committee meets regularly to approve new credit applications and renewals within the delegated limits set by the Board. The committee also regularly makes recommendations to the Board Credit Committee on the revision of limits. All approvals are independent of the originating business unit.

## Monitoring and Evaluation

The Board assesses its own performance and that of management in the discharge of their duties and responsibilities and develops and submits to the Central Bank of Kenya an annual self-assessment of the Board performance.

## Reckless and Fraudulent Activities

The Board of Directors ensures that the institution and management do not;

- (a) Allow a credit facility or guarantee to remain outstanding;
- (b) Incur any liability;
- (c) Enter into any contract or transaction; or
- (d) Conduct its business or part thereof in a fraudulent or reckless manner detrimental to the institution's interest or the interest of depositors or the general public, as directed in the Microfinance Act 2006 (s.32).

## Scheme of Arrangement

The Board of Directors ensures that the institution does not enter into any scheme of arrangement with its creditors.

## Restriction on Trading and Investment

The Board of Directors certifies that Faulu Microfinance Bank Limited:

- (a) Has not acquired or held, directly or indirectly, any part of the share capital of; or
- (b) Have a beneficial interest in any financial, commercial, agricultural, industrial or other undertaking, where the value of the institution's interest exceeds 25% in the aggregate of the institution's core capital, except in an undertaking in fulfilment of a debt due to the institution.

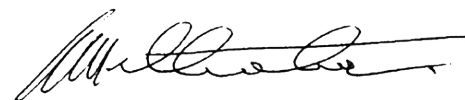
## Single Borrower Limit

The institution did not extend loans exceeding 5% of its core capital to any single end-user borrower. The Board of Directors ensures that loans or credit facilities equivalent to the maximum limit are extended only to those borrowers who have the capacity or have an established track record of satisfactory repayment. Faulu Microfinance Bank Limited has well-defined credit policies and procedures covering the maximum lending limits and approval

levels, rate to be charged, repayment period, loan tracking and collateral. The institution granted loans to 2 single end users that exceeded 2% of its core capital. The aggregate amount of loans was not more than 70% of the Bank's total loan portfolio.

## KYC Requirements

The Board of Directors ensures that Management obtains and maintains proper identification of customers wishing to open accounts or make transactions or enter into an engagement with the institution whether directly or indirectly through proxy; and maintains adequate and accurate records for a minimum of seven years regarding its customers, sources of funds and transactions, as required by the Microfinance Act 2006



Dr. Peter Wanyaga Muthoka- D.M.L, M.A(Ed.)  
B.A (Hons), EBS, MBS, FKIB, FKIM, MID  
Chairman



Apollo N. Njoroge  
Managing Director

## Legal and Compliance Audit Opinion



== LAW LLP ==

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- The Board of Directors of Faulu Microfinance Bank Limited (“the Company”) commissioned a legal and compliance audit with the aim of enhancing governance through assessing the levels of compliance by the Company with the laws, regulations and standards applicable to it. The legal and compliance audit was headed by Mugambi Nandi, Senior Partner, KN Law LLP.

Our responsibility is to express an opinion on the level of compliance by the company to laws, regulations and standards applicable to the Company. We conducted an on-site legal and compliance audit and prepared:

- a Compliance Matrix identifying each of the Company’s compliance obligations arising under the applicable laws, regulations and standards; and
- an Information Request List detailing the documents, information or confirmations required from the Company to assess its adherence to the compliance obligations.

Using the Information Request as the basis for the information gathering and the Compliance Matrix as the tool to determine compliance, we have made an assessment of the compliance by the Company with the various applicable laws, regulations and standards.

### Opinion

In our opinion, there were no material incidences of non-compliance by the Company with the laws, regulations and standards applicable to it and in this regard we issue an unqualified opinion.

Mugambi Nandi  
Practice No: LSK/2019/00436  
KN Law LLP

May 28, 2019

Date

Advocates • Notaries Public • Tax Agents

Advocates: Mugambi Nandi | Doreen Onwong’a | Emmanuel Mueke | Samuel Kioko | Ronnie Sigei | Makena King’ori | Brian Rono  
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- ▶ The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Group and the Bank as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Group and the Bank maintain proper accounting records that are sufficient to show and explain the transactions of the company and disclose, with reasonable accuracy, the financial position of the Group and the Bank. The directors are also responsible for safeguarding the assets of the Group and the Bank, and for taking reasonable steps for the prevention and detection of fraud and error.

The directors accept responsibility for the preparation and presentation of these financial statements in accordance with the International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. They also accept responsibility for:

- (i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;
- (ii) selecting suitable accounting policies and then applying them consistently; and
- (iii) making accounting estimates and judgements that are reasonable in the circumstances.

Having made an assessment of the Group's and the Bank's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the Group and Bank's ability to continue as a going concern.

The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibilities.

Approved by the Board of Directors on 4th March 2020 and signed on its behalf by:



**Dr. Peter Wanyaga Muthoka**  
D.ML, M.A (Ed.) B.A (Hons), EBS, MBS, FKIB, FKIM, MID  
Chairman



**Apollo N. Njoroge**  
Managing Director

## Statement Of Directors' Responsibilities



## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FAULU MICROFINANCE BANK LIMITED

### Report on the Audit of the Consolidated and Bank Financial Statements

#### Opinion

We have audited the accompanying financial statements of Faulu Microfinance Bank Limited (the "bank") and its subsidiary (together, the "group"), set out on pages 63 to 119, which comprise the group and bank statement of financial position as at 31 December 2019, and the group and bank statements of profit or loss and other comprehensive income, the group and bank statement of changes in equity and the group and bank statements of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the group and bank financial statements give a true and fair view of the group and bank financial position as at 31 December 2019 and of their group and bank financial performance and group and bank cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") and the requirements of the Kenyan Companies Act, 2015.

#### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), which is consistent with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Other Information

The directors are responsible for the other information, which comprises corporate information,

chairman's statement, report of the directors and corporate governance statement. The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the group and bank financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the group and bank financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the group and bank financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

### Responsibilities of the Directors and Those Charged with Governance

The directors are responsible for the preparation of the group and bank financial statements that give a true and fair view in accordance with IFRS and the requirements of the Kenyan companies Act, and for such internal controls as directors determine are necessary to enable the preparation of group and bank financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the group and bank financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group and bank or to cease operations, or have no realistic alternative but to do so. Those charged with governance are responsible for overseeing the Group financial reporting process.

## Auditor's Responsibilities for the Audit of the Consolidated and Bank financial statements

Our objectives are to obtain reasonable assurance about whether the group and bank financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the group and bank financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated and separate financial statements or, if such disclosures are inadequate, to

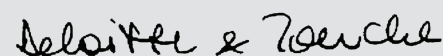
modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern

- Evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the group and bank financial statements represent the underlying transactions and events in a manner that achieves fair presentation
- Obtain sufficient appropriate audit evidence regarding the group and bank financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit

### Report on other matters prescribed by the Kenyan Companies Act, 2015

In our opinion, the information given in the report of the directors on pages 49 to 51 is consistent with the group and bank financial statements.



**Certified Public Accountants (Kenya)**  
Nairobi, Kenya

**25th March 2020**

**CPA Anne Muraya, Practising certificate No. 1697**

Signing partner responsible for the independent audit

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## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

### FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Interest income	5	4,870,387	4,045,629	4,870,387	4,045,629
Interest expense	6	(2,300,721)	(2,114,353)	(2,300,721)	(2,114,353)
<b>Net interest income</b>		<b>2,569,666</b>	<b>1,931,276</b>	<b>2,569,666</b>	<b>1,931,276</b>
Fees and commissions	7	566,113	566,994	534,267	539,596
Foreign exchange gains/ (losses)		1,265	(521)	1,265	(521)
Other operating income	8	37,639	22,896	33,333	19,015
<b>Operating income</b>		<b>3,174,683</b>	<b>2,520,645</b>	<b>3,138,531</b>	<b>2,489,366</b>
Administration and operating expenses	9	(2,132,961)	(2,128,510)	(2,121,652)	(2,112,528)
Impairment losses on loans and receivables	11	(561,610)	(109,407)	(562,714)	(107,855)
		(2,694,571)	(2,237,917)	(2,684,366)	(2,220,383)
<b>Operating profit</b>		<b>480,112</b>	<b>282,728</b>	<b>454,165</b>	<b>268,983</b>
Share of associate company's profit	18	2,307	4,632	2,307	4,632
		482,419	287,360	456,472	273,615
Taxation charge	12(a)	(152,288)	(96,916)	(144,509)	(92,709)
<b>Profit for the year</b>		<b>330,131</b>	<b>190,444</b>	<b>311,963</b>	<b>180,906</b>
<b>Other comprehensive income for the year</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total comprehensive income for the year</b>		<b>330,131</b>	<b>190,444</b>	<b>311,963</b>	<b>180,906</b>

## STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2019

	Note	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
<b>ASSETS</b>					
Local currency cash		408,188	349,311	408,188	349,311
Balances due from banks and financial institutions		212,700	677,882	212,700	677,882
Short term deposits with banks	13	1,349,702	1,963,446	1,349,702	1,963,446
Cash balances with Central Bank of Kenya	14	1,019,103	1,029,099	1,019,103	1,029,099
Loans to customers	15	19,776,742	17,973,688	19,776,742	17,973,688
Government securities	16	3,469,378	1,879,900	3,469,378	1,879,900
Other assets	17	268,927	331,887	265,493	324,770
Tax recoverable	12(c)	-	167,935	-	167,935
Due from related companies	30(a)	27,169	41,514	29,658	54,037
Investment in associate companies	18(a)	53,039	51,424	53,039	51,424
Investment in a subsidiary	18(b)	-	-	1,000	1,000
Deferred tax asset	19	584,798	461,163	584,671	460,713
Property and equipment	20	1,345,961	1,414,662	1,345,564	1,414,170
Intangible assets	21	712,412	877,561	712,412	877,561
Right-of-use asset	22	453,867	-	453,867	-
<b>TOTAL ASSETS</b>		<b>29,681,986</b>	<b>27,219,472</b>	<b>29,681,517</b>	<b>27,224,936</b>
<b>LIABILITIES AND EQUITY</b>					
<b>LIABILITIES</b>					
Cash collaterals	23	491,063	588,844	491,063	588,844
Customer deposits	24	19,538,740	17,891,042	19,601,300	17,940,968
Borrowings	25	4,366,275	4,430,520	4,366,275	4,430,520
Other liabilities	26	860,347	740,923	847,157	727,121
Lease liabilities	27	488,659	-	488,659	-
Tax payable	12(c)	48,124	1,301	45,812	-
Due to related companies	30(b)	65,409	73,604	65,409	73,604
		<b>25,858,617</b>	<b>23,726,234</b>	<b>25,905,675</b>	<b>23,761,057</b>
<b>EQUITY</b>					
Share capital	28	480,000	480,000	480,000	480,000
Share premium		2,899,759	2,899,759	2,899,759	2,899,759
Retained earnings / (accumulated deficit)		188,957	(142,025)	141,430	(171,384)
Revaluation surplus		254,653	255,504	254,653	255,504
		<b>3,823,369</b>	<b>3,493,238</b>	<b>3,775,842</b>	<b>3,463,879</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>29,681,986</b>	<b>27,219,472</b>	<b>29,681,517</b>	<b>27,224,936</b>

The financial statements on pages 63 to 119 were approved and authorised for issue by the board of directors on 4th March 2020 and were signed on its behalf by:

Dr. Peter W. Muthoka EBS MBS FKIM FKIB  
Chairman

Joshua Muiru  
Director

Apollo N. Njoroge  
Managing Director

Nkirote K. Mworira  
Company Secretary

## STATEMENT OF CHANGES IN EQUITY

### FOR THE YEAR ENDED 31 DECEMBER 2019

	Group				
	Share capital Shs'000	Share premium Shs'000	Retained earnings (accumulated deficit) Shs'000	Revaluation surplus Shs'000	Total Shs'000
At 1 January 2018	480,000	2,899,759	(336,880)	259,915	3,302,794
Total comprehensive income for the year	-	-	190,444	-	190,444
Transfer of excess depreciation net of deferred tax	-	-	4,411	(4,411)	-
<b>At 31 December 2018</b>	<b>480,000</b>	<b>2,899,759</b>	<b>(142,025)</b>	<b>255,504</b>	<b>3,493,238</b>
At 1 January 2019	480,000	2,899,759	(142,025)	255,504	3,493,238
Total comprehensive income for the year	-	-	330,131	-	330,131
Transfer of excess depreciation net of deferred tax	-	-	851	(851)	-
<b>At 31 December 2019</b>	<b>480,000</b>	<b>2,899,759</b>	<b>188,957</b>	<b>254,653</b>	<b>3,823,369</b>

## STATEMENT OF CHANGES IN EQUITY

### FOR THE YEAR ENDED 31 DECEMBER 2019

	Bank				Total Shs'000
	Share capital Shs'000	Share premium Shs'000	Retained earnings (accumulated deficit) Shs'000	Revaluation surplus Shs'000	
At 1 January 2018	480,000	2,899,759	(356,701)	259,915	3,282,973
Total comprehensive income for the year	-	-	180,906	-	180,906
Transfer of excess depreciation net of deferred tax	-	-	4,411	(4,411)	-
<b>At 31 December 2018</b>	<b>480,000</b>	<b>2,899,759</b>	<b>(171,384)</b>	<b>255,504</b>	<b>3,463,879</b>
At 1 January 2019	480,000	2,899,759	(171,384)	255,504	3,463,879
Total comprehensive income for the year	-	-	311,963	-	311,963
Transfer of excess depreciation net of deferred tax	-	-	851	(851)	-
<b>At 31 December 2019</b>	<b>480,000</b>	<b>2,899,759</b>	<b>141,430</b>	<b>254,653</b>	<b>3,775,842</b>

## STATEMENT OF CASH FLOWS

### FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Cash (used in) / generated from operations	29(a)	(656,406)	962,765	(662,851)	958,598
Taxation paid	12(c)	(60,473)	(45,916)	(54,028)	(41,944)
<b>Net cash (used in) / generated from operating activities</b>		<b>(716,879)</b>	<b>916,849</b>	<b>(716,879)</b>	<b>916,654</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Proceeds from sale of a motor vehicles		1,365	-	1,365	-
Purchase of property and equipment	20	(93,927)	(149,057)	(93,927)	(148,862)
Purchase of intangible asset	21	(10,873)	(40,384)	(10,873)	(40,384)
<b>Net cash used in investing activities</b>		<b>(103,345)</b>	<b>(189,441)</b>	<b>(103,435)</b>	<b>(189,246)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Borrowings received	29(c)	1,889,657	2,551,174	1,889,657	2,551,174
Borrowings repaid	29(c)	(1,953,902)	(1,692,428)	(1,953,902)	(1,692,428)
Lease repayments	27	(135,490)	-	(135,490)	-
<b>Net cash (used in)/ generated from financing activities</b>		<b>(199,735)</b>	<b>858,746</b>	<b>(199,735)</b>	<b>858,746</b>
<b>(DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS</b>		<b>(1,020,049)</b>	<b>1,586,154</b>	<b>(1,020,049)</b>	<b>1,586,154</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>		<b>2,990,639</b>	<b>1,404,485</b>	<b>2,990,639</b>	<b>1,404,485</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	29(b)	<b>1,970,590</b>	<b>2,990,639</b>	<b>1,970,590</b>	<b>2,990,639</b>

# HAKIKA SAVINGS PLAN



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# NOTES TO THE FINANCIAL STATEMENTS

## FOR THE YEAR ENDED 31 DECEMBER 2019

### 1. ACCOUNTING POLICIES

#### Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Kenyan Companies Act, 2015.

For the Kenyan Companies Act reporting purposes, in these financial statements, the balance sheet is represented by/is equivalent to the statement of financial position and the profit and loss account is presented in the statement of profit or loss and other comprehensive income.

#### Application of new and revised International Financial Reporting Standards (IFRSs)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2019

The following new and revised IFRSs were effective in the current year but had no material impact on the amounts reported in these financial statements.

##### Impact of initial application of IFRS 16 Leases

In the current year, the Group has applied IFRS 16 Leases (as issued by the IASB in January 2016) that is effective for annual periods that begin on or after 1 January 2019.

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance lease and requiring the recognition of a right-of-use asset and a lease liability at commencement for all leases, except for short-term leases and leases of low value assets when such recognition exemptions are adopted. In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged. The impact of the adoption of IFRS 16 on the Group's consolidated financial statements is described below.

The date of initial application of IFRS 16 for the Group is 1 January 2019.

The Group has applied IFRS 16 using the cumulative catch-up transition method, without restating the comparative information. The Group has recognized lease liabilities at the date of initial application for leases previously classified as an operating lease applying IAS 17. The lease liabilities have been measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.

The Group has recognised a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IAS 17. The Group has, on a lease-by-lease basis, measured the right-of-use asset at its carrying amount as if the Standard had been applied since the commencement date, but discounted using the Group's incremental borrowing rate at the date of initial application.

##### (a) Impact of the new definition of a lease

The Group has made use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with IAS 17 and IFRIC 4 will continue to be applied to those contracts entered or modified before 1 January 2019.

The change in definition of a lease mainly relates to the concept of control. IFRS 16 determines whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time in exchange for consideration. This is in contrast to the focus on 'risks and rewards' in IAS 17 and IFRIC 4.

The Group applies the definition of a lease and related guidance set out in IFRS 16 to all contracts entered into or changed on or after 1 January 2019. In preparation for the first-time application of IFRS 16, the Group has carried out a review of all the lease contracts. The review has shown that the new definition in IFRS 16 will not significantly change the scope of contracts that meet the definition of a lease for the Group.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2019 (Continued)

#### Impact of initial application of IFRS 16 Leases (Continued)

##### (b) Impact on Lessee Accounting

###### (i) Former operating leases

IFRS 16 changes how the Group accounts for leases previously classified as operating leases under IAS 17, which were off balance sheet.

Applying IFRS 16, for all leases (except as noted below), the Group:

- Recognises right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;
- Recognises depreciation of right-of-use assets and interest on lease liabilities in profit or loss;
- Separates the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within financing activities) in the statement of cash flows.

Lease incentives (e.g. rent-free period) are recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease incentive, amortised as a reduction of rental expenses generally on a straight-line basis.

Under IFRS 16, right-of-use assets are tested for impairment in accordance with IAS 36.

###### (ii) Former finance leases

The main differences between IFRS 16 and IAS 17 with respect to contracts formerly classified as finance leases is the measurement of the residual value guarantees provided by the lessee to the lessor. IFRS 16 requires that the Society recognises as part of its lease liability only the amount expected to be payable under a residual value guarantee, rather than the maximum amount guaranteed as required by IAS 17. This change did not have a material effect on the Group's financial statements.

##### (c) Impact on Lessor Accounting

IFRS 16 does not change substantially how a lessor accounts for leases. Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account

for those two types of leases differently. However, IFRS 16 has changed and expanded the disclosures required, in particular regarding how a lessor manages the risks arising from its residual interest in leased assets.

The Group is not a lessor in any lease arrangement therefore there is no impact on lessor accounting.

##### (d) Financial impact of the initial application of IFRS 16

The weighted average lessees incremental borrowing rate applied to lease liabilities recognised in the statement of financial position on 1 January 2019 is 9%

The following table shows the operating lease commitments disclosed applying IAS 17 at 31 December 2018, discounted using the incremental borrowing rate at the date of initial application and the lease liabilities recognised in the statement of financial position at the date of initial application.

	Shs '000
Operating lease commitments at 31 December 2018	450,715
Effect of lease extensions	135,118
Effect of discounting the above amounts	(7,716)
<b>Lease liabilities recognised at 1 January 2019</b>	<b>578,117</b>

#### Impact on assets, liabilities and equity as at 1 January 2019

	As previously reported Sh'000	IFRS 16 adjustments Sh'000	After IFRS 16 adjustments Shs'000
Right-of-use assets	578,117	-	578,117
Lease liabilities	(578,117)	-	(578,117)
<b>Retained earnings</b>	<b>-</b>	<b>-</b>	<b>-</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2019 (Continued)

##### (d) Financial impact of the initial application of IFRS 16 (Continued)

The application of IFRS 16 has an impact on the statement of cash flows of the Group. Under IFRS 16, lessees must present cash payments for the principal portion for a lease liability, as part of financing activities. Under IAS 17, all lease payments on operating leases were presented as part of cash flows from operating activities.

In the current year, the Group has applied a number of amendments to IFRS Standards and Interpretations issued by the IASB that are effective for an annual period that begins on or after 1 January 2019. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

##### Amendments to IFRS 9 Prepayment Features with Negative Compensation

The Group has adopted the amendments to IFRS 9 for the first time in the current year. The amendments to IFRS 9 clarify that for the purpose of assessing whether a prepayment feature meets the 'solely payments of principal and interest' (SPPI) condition, the party exercising the option may pay or receive reasonable compensation for the prepayment irrespective of the reason for prepayment. In other words, financial assets with prepayment features with negative compensation do not automatically fail SPPI.

##### Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures

The Group has adopted the amendments to IAS 28 for the first time in the current year. The amendment clarifies that IFRS 9, including its impairment requirements, applies to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture. The Group applies IFRS 9 to such long-term interests before it applies IAS 28. In applying IFRS 9, the Group does not take account of any adjustments to the carrying amount of long-term interests required by IAS 28 (i.e., adjustments to the carrying amount of long-term interests arising from the allocation of losses of the investee or assessment of impairment in accordance with IAS 28).

##### Annual Improvements to IFRS Standards 2015–2017 Cycle Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs

The Group has adopted the amendments included in the Annual Improvements to IFRS Standards 2015–2017 Cycle for the first time in the current year. The Annual Improvements include amendments to four Standards:

##### IAS 12 Income Taxes

The amendments clarify that the Group should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the Bank originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

##### IAS 23 Borrowing Costs

The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

##### IFRS 11 Joint Arrangements

The amendments clarify that when a party that participates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the Group does not remeasure its PHI in the joint operation.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2019 (Continued)

#### Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement

The Group has adopted the amendments of IAS 19 for the first time in the current year. The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. The Group will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19:99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

#### IFRIC 23 Uncertainty over Income Tax Treatments

The Group has adopted IFRIC 23 for the first time in the current year. IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires the Group to:

- determine whether uncertain tax positions are assessed separately or as a Group; and
- assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:

- If yes, the Group should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
- If no, the Group should reflect the effect of uncertainty in determining its accounting tax position using either the most likely amount or the expected value method.

The amendments to the standard had no impact on the Group's financial statements.

##### (ii) New and revised IFRS Standards in issue but not yet effective for the year ended 31 December 2019

At the date of authorisation of these financial statements, the Group has not applied the following new and revised IFRS Standards that have been issued but are not yet effective:

New and Amendments to standards	Effective for annual periods beginning on or after
IFRS 17-Insurance	1 January 2021, with earlier application permitted
Amendments to IAS 10 and IAS 28 Sale or Contribution of Assets between an investor and its Associate or Joint Venture	Yet to be set, however earlier application permitted
Amendments to IFRS 3 Definition of a business	1 January 2020, with earlier application permitted
Amendments to IAS 1 and IAS 8- Definition of material	1 January 2020, with earlier application permitted
Conceptual Framework: Amendments to References to the Conceptual Framework in IFRS standards	January 2020, with earlier application permitted

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (ii) New and revised IFRS Standards in issue but not yet effective for the year ended 31 December 2019

The Directors do not expect that the adoption of the Standards listed above will have a material impact on the financial statements of the Group in future periods, except as noted below:

##### **IFRS 10 and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture**

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted. The directors of the Group anticipate that the application of these amendments may have an impact on the financial statements in future periods should such transactions arise.

The Directors of the Group are currently assessing the impact of these amendments and plan to adopt the amendments on the required effective date if necessary.

##### **Amendments to IFRS 3 Definition of a business**

The amendments clarify that while businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business. To be considered a business an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.

Additional guidance is provided that helps to determine whether a substantive process has been acquired.

The amendments introduce an optional concentration test that permits a simplified assessment of whether an acquired set of activities and assets is not a business. Under the optional concentration test, the acquired set of activities and assets is not a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar assets.

The amendments are applied prospectively to all business combinations and asset acquisitions for which the acquisition date is on or after the first annual reporting period beginning on or after 1 January 2020, with early application permitted.

The Directors of the Group are currently assessing the impact of these amendments and plan to adopt the amendments on the required effective date if necessary.

##### **Amendments to IAS 1 and IAS 8 Definition of material**

The amendments are intended to make the definition of material in IAS 1 easier to understand and are not intended to alter the underlying concept of materiality in IFRS Standards. The concept of 'obscuring' material information with immaterial information has been included as part of the new definition.

The threshold for materiality influencing users has been changed from 'could influence' to 'could reasonably be expected to influence'.

The definition of material in IAS 8 has been replaced by a reference to the definition of material in IAS 1. In addition, the IASB amended other Standards and the Conceptual Framework that contain a definition of material or refer to the term 'material' to ensure consistency.

The amendments are applied prospectively for annual periods beginning on or after 1 January 2020, with earlier application permitted. The Directors of the Group are currently assessing the impact of these amendments and plan to adopt the amendments on the required effective date if necessary.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### Amendments to References to the Conceptual Framework in IFRS Standards

Together with the revised Conceptual Framework, which became effective upon publication on 29 March 2018, the IASB has also issued Amendments to References to the Conceptual Framework in IFRS Standards. The document contains amendments to IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22, and SIC-32.

Not all amendments, however, update those pronouncements with regard to references to and quotes from the framework so that they refer to the revised Conceptual Framework. Some pronouncements are only updated to indicate which version of the Framework they are referencing to (the IASB Framework adopted by the IASB in 2001, the IASB Framework of 2010, or the new revised Framework of 2018) or to indicate that definitions in the Standard have not been updated with the new definitions developed in the revised Conceptual Framework.

The amendments, where they actually are updates, are effective for annual periods beginning on or after 1 January 2020, with early application permitted.

##### (iii) Early adoption of standards

The Group did not early-adopt any new or amended standards in 2019.

##### (a) Basis of preparation

The consolidated financial statements are prepared under the historical cost convention, as modified to include revaluation of certain assets at fair value.

##### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary Faulu Microfinance Bank Insurance Agency Limited for the made up to 31 December each year. Subsidiaries are those companies in which the bank has power to

exercise control over the operations of the entities. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the group. Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

##### (b) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised within the profit or loss on accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Fair value changes on other derivatives held for risk management purposes, and other financial assets and liabilities carried at fair value through profit or loss, are presented in net income on other financial instruments carried at fair value in the profit or loss.

Once a financial asset or a portfolio of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (c) Investment in associate company

An associate is an entity over which the company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the statement of financial position at cost as adjusted for post-acquisition changes in the company's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the company's interest in that associate are recognised only to the extent that the company has incurred legal or constructive obligations or made payments on behalf of the associate.

#### (d) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

##### (i) Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

##### (ii) Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such

deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (e) Fees and commission

In the normal course of business, the company earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, are recognised as the related services are performed.

Other fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

#### (f) Property and equipment

Property and equipment are stated at cost or as professionally revalued less accumulated depreciation and any impairment charge. Professional valuations are carried out in accordance with the company's policy of revaluing freehold land and buildings. Revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair values at the end of each reporting period and at least once in every three years.

#### (f) Property and equipment

Any revaluation increase arising on revaluation of such property, plant and equipment is recognised in other comprehensive income, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on revaluation of such property, plant and equipment is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the revaluation surplus reserve relating to a previous revaluation of that asset.

#### (g) Depreciation

Depreciation on property and equipment is calculated on the reducing balance at the following annual rates:

Motor vehicles	25.0%
Computers and equipment	30.0%
Electronic office equipment	25.0%
Durable non-electrical equipment	12.5%
Buildings on freehold land	2.5%
Freehold land	nil

Depreciation is recognised in profit or loss. On subsequent sale or retirement of a revalued property and equipment, the attributable revaluation surplus remaining in the revaluation reserve is transferred directly to equity. Each year, the difference between depreciation based on the revalued carrying amount of an asset (the depreciation charged to the profit or loss) and the depreciation based on the assets' original cost is transferred from the revaluation surplus to revenue reserves, net of related deferred taxation.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

#### (h) Work in progress

Work in progress relates to construction of the banking halls for the branches. Cost includes materials, direct labour and any other direct expenses incurred in respect of the project. The amounts are transferred to property and equipment once is completed and commissioned. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (i) Intangible assets - computer software development costs

Costs incurred on computer software are initially accounted for at cost as intangible assets and subsequently at cost less any accumulated amortisation and accumulated impairment losses. Amortisation is calculated on a straight line basis over the estimated useful lives.

#### (j) Leases

The Group has applied IFRS 16 using modified cumulative catch up approach; the Group has not restated its comparative figure but recognises the cumulative effect of adopting IFRS 16.

#### Policy applicable from 1 January 2019

The Group assesses whether a contract is or contains a lease at inception of the contract. The Group recognises a right of use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets. For these leases, the Group recognises the lease payments as an operating expense on a straight line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which the economic benefits from the leased assets are consumed.

#### Discount rate

The lease term has changed or there is a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate. The discount rate used is the incremental borrowing rate at 9 % the rate that the Group will be charged if it borrows at the current market.

#### Lease term/period

The lease period/term is determined by reviewing the signed lease contract i.e. the start of the lease and end of lease period.

#### Lease payments

The lease payments are paid in advance at the beginning of each quarter from start of the lease date. The lease payments varies with lessors some fixed payments others variable with escalation clauses.

The Group re-measures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

The lease term has changed or there is a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.

The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using the initial discount rate (unless the lease payments change is due to a change in floating interest rate, in which case a revised discount rate is used) a lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.

The Group did not make any such adjustments during the periods presented.

The right-of-use asset comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use asset is depreciated over the shorter period of lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the Group expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

The right-of-use asset is presented as a separate line in the statement of financial position.

Variable rents that do not depend on an index or rate are not included in the measurement of the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line 'Operating expenses' in the statement of the profit or loss.

In addition, the right of use asset is periodically reduced by impairment losses if any and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the Group's incremental borrowing rate.

The Group has elected not to recognise right of use assets and lease liabilities for leases less than 12 months and leases of low value assets.

#### **(k) Impairment of tangible and intangible assets excluding goodwill**

At the end of each reporting date, the group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present

value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### **(l) Retirement benefit obligations**

##### **i) Company's defined contribution pension scheme**

The company operates a defined contribution pension scheme for its permanent employees. The assets of the scheme are held and administered independently of the company's assets. The scheme is funded by contributions from both the company and employees. The company's contribution to the scheme is limited to 10 per cent of the employees' basic salary while employees contribute 5 per cent of their basic salary. The company's contribution is charged to the profit or loss in the year to which it relates.

##### **ii) Statutory defined contribution pension scheme**

The company also contributes to the statutory National Social Security Fund. This is a defined contribution scheme to which the company's obligation is limited to a specified contribution per employee per month and is charged to the profit or loss in the year to which it relates.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### iii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the liability for annual leave outstanding at the end of each reporting period.

#### (m) Foreign currencies

Transactions in foreign currencies are translated at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses on exchange of monetary items are dealt with in the profit or loss in the period in which they arise.

#### (n) Financial instruments

Financial assets and financial liabilities are recognised in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

#### Classification and measurement

The Group classifies its financial assets into three principal classification categories based on the cash flow characteristics of the asset and the business model assessment:

- Measured at Amortised Cost;
- Fair Value through Other Comprehensive Income (FVOCI); and
- Fair Value through Profit or Loss (FVTPL)

Financial instruments measured at amortised cost, per IFRS, in this AFS refer to financing arrangements and other assets.

#### Amortised cost

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and Interest (SPPI) on the principal amount outstanding.

The Group recognises cash and balances with Central Bank, balances due from banking institutions, financing arrangements and other assets at amortised cost.

#### Fair Value through Other Comprehensive Income (FVOCI)

A financial asset which is a debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and Interest (SPPI) on the principal amount outstanding.

The Group has no financial assets classified at FVOCI.

#### Fair Value through Other Comprehensive Income (FVOCI) – Equity

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by investment basis. The Group currently does not have any equity investments.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (n) Financial instruments (Continued)

The Group does not have financial assets classified at FVTPL. A financial asset is classified into one of these categories on initial recognition.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of IFRS 9 are not separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

##### (i) Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank compares the risk of a default occurring on the financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered includes the future prospects of the industries in which the Banks's borrowers operate, obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organisations, as well as consideration of various external sources of actual and forecast economic information that relate to the Group's core operations.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- an actual or expected significant deterioration in the financial instrument's external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk for a particular financial instrument, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor, or the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost;
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;

- an actual or expected significant deterioration in the operating results of the borrower;
- significant increases in credit risk on other financial instruments of the same borrower;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant decrease in the borrower's ability to meet its debt obligations.

Irrespective of the outcome of the above assessment, the Bank presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Bank has reasonable and supportable information that demonstrates otherwise.

Despite the foregoing, the Group assumes that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. A financial instrument is determined to have low credit risk if:

- The financial instrument has a low risk of default,
- The borrower has a strong capacity to meet its contractual cash flow obligations in the near term,
- Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Group considers a financial asset to have low credit risk when the asset has external credit rating of 'investment grade' in accordance with the globally understood definition or if an external rating is not available, the asset has an internal rating of 'performing'. Performing means that the counterparty has a strong financial position and there is no past due amounts.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (n) Financial instruments (Continued)

##### **Derecognition of financial assets**

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset measured at amortised cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognised in profit or loss. In addition, on derecognition of an investment in a debt instrument classified as at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss. In contrast, on derecognition of an investment in equity instrument, which the Bank has elected on initial recognition to measure at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is not reclassified to profit or loss, but is transferred to retained earnings.

##### **Financial liabilities**

After initial recognition, the company measures all financial liabilities including customer deposits, cash collaterals other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

##### **Derecognition of financial liabilities**

Financial liabilities are derecognised when and only when the company obligations are discharged, cancelled or they expire. The difference between the carrying amount of the

financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

##### **Borrowings**

Borrowings are recorded at the proceeds received. Finance charges, including premiums payable on settlement or redemption, are accounted for on the accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

#### (o) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position where there is a legal enforceable right to set off the recognised amounts and there is an intention to settle on net basis, or realise the asset and settle the liability simultaneously.

#### (p) Cash and cash equivalents

For the purposes of the statement of cash flows, cash equivalents include short term liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the dates of the advances.

#### (q) Statutory reserve

Where impairment losses required by the microfinance (Deposit Taking Institutions) Regulation 2008 issued by the Central Bank of Kenya exceed those computed under International Financial Reporting Standards (IFRS), the excess is recognised as a statutory reserve and accounted for as an appropriation from revenue reserves. The reserve is not available for distribution.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 1. ACCOUNTING POLICIES (CONTINUED)

#### (r) Revaluation reserve

This arises on revaluation of land and buildings and is not distributable. When revalued land or buildings are sold, the portion of the properties revaluation reserve that relates to that asset is transferred directly to retained earnings. Items of other comprehensive income included in the properties revaluation reserve will not be reclassified subsequently to profit or loss.

#### (s) Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year

### 2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In applying the Group's accounting policies, the directors are required to make judgements (other than those involving estimations) that have a significant impact on the amounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. These are dealt with below:

#### Critical accounting judgements in applying the company's policies

##### Business model assessment

Classification and measurement of financial assets depends on the results of the SPPI and the business model test. The Bank determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Bank monitors financial assets measured at amortised cost that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Bank's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets. No such changes were required during the periods presented.

##### Significant increase in credit risk

As explained in note 1, ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased, the Bank takes into account qualitative and quantitative reasonable and supportable forward-looking information.

#### Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

#### Key sources of estimation uncertainty (Continued)

##### Taxation provisions

Judgement is required in determining the provision for income taxes due to the complexity of legislation. There are many transactions and calculations for which ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

The Group recognises the net future tax benefit that relates to deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires the Bank to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Group to realise the net deferred tax assets recorded at the reporting date could be impacted.

##### Calculation of loss allowance:

When measuring expected credit losses the Group uses reasonable and supportable forward looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

Loss given default is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

Probability of default constitutes a key input in measuring ECL. Probability of default is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.

##### Property and equipment

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

##### Fair value measurement and valuation

Some of the group's assets and liabilities are measured at fair value for financial reporting process. In estimating the fair value of an asset or liabilities, the Group uses market – observable data to the extent it is available. Where level 1 inputs are not available, the company engages third party qualified valuers to perform the valuation.

##### Leases

Judgement is required in determination of the appropriate rate to discount the lease payments and the assessment of whether a right-of-use asset is impaired.

### 3. FINANCIAL RISK MANAGEMENT

The group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks

#### a) Credit risk

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the company's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the company considers and consolidates all elements of credit risk exposure.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Credit risk management

The Bank's Risk Compliance and Credit committee is responsible for managing the Group's credit risk by:

- Ensuring that the Bank has appropriate credit risk practices, including an effective system of internal control, to consistently determine adequate allowances in accordance with the Bank's stated policies and procedures, IFRS and relevant supervisory guidance.
- Identifying, assessing and measuring credit risk across the Bank, from an individual instrument to a portfolio level.
- Creating credit policies to protect the Bank against the identified risks including the requirements to obtain collateral from borrowers, to perform robust ongoing credit assessment of borrowers and to continually monitor exposures against internal risk limits.
- Limiting concentrations of exposure by type of asset, counterparties, industry, credit rating, geographic location etc.
- Establishing a robust control framework regarding the authorisation structure for the approval and renewal of credit facilities.
- Developing and maintaining the Bank's risk grading to categorise exposures according to the degree of risk of default. Risk grades are subject to regular reviews.
- Developing and maintaining the Bank's processes for measuring ECL including monitoring of credit risk, incorporation of forward-looking information and the method used to measure ECL.
- Ensuring that the Bank has policies and procedures in place to appropriately maintain and validate models used to assess and measure ECL.
- Establishing a sound credit risk accounting assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess credit risk and to account for ECL. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

The internal audit function performs regular audits making sure that the established controls and procedures are adequately designed and implemented.

#### Significant increase in credit risk

As explained in note 1 the Bank monitors all financial assets that are subject to impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk the Bank will measure the loss allowance based on lifetime rather than 12-month ECL.

#### Internal credit risk ratings

In order to minimise credit risk, the Bank has tasked its credit management committee to develop and maintain the Bank's credit risk grading to categorise exposures according to their degree of risk of default. The Bank's credit risk grading framework comprises ten categories. The credit rating information is based on a range of data that is determined to be predictive of the risk of default and applying experienced credit judgement. The nature of the exposure and type of borrower are taken into account in the analysis. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default.

The credit risk grades are designed and calibrated to reflect the risk of default as credit risk deteriorates. As the credit risk increases the difference in risk of default between grades changes.

Each exposure is allocated to a credit risk grade at initial recognition, based on the available information about the counterparty. All exposures are monitored and the credit risk grade is updated to reflect current information. The monitoring procedures followed are both general and tailored to the type of exposure.

The following data are typically used to monitor the Bank's exposures:

- Payment record, including payment ratios and ageing analysis;
- Extent of utilisation of granted limit;
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies;
- For retail exposures: internally generated data of customer behaviour, affordability metrics etc.; and
- For corporate exposures: information obtained by periodic review of customer files including audited financial statements review, changes in the financial sector the customer operates etc.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Significant increase in credit risk (Continued)

The Bank uses credit risk grades as a primary input into the determination of the term structure of the PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. The information used is both internal and external depending on the portfolio assessed.

The Bank analyses all data collected using statistical models and estimates the remaining lifetime PD of exposures and how these are expected to change over time. The factors taken into account in this process include macro-economic data such as GDP growth, unemployment, benchmark interest rates and house prices. The Bank generates a 'base case' scenario of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Bank then uses these forecasts, which are probability-weighted, to adjust its estimates of PDs.

The Bank uses different criteria to determine whether credit risk has increased significantly per portfolio of assets. The criteria used are both quantitative changes in PDs as well as qualitative.

Irrespective of the outcome of the above assessment, the Bank presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due unless the Bank has reasonable and supportable information that demonstrates otherwise.

The Bank has monitoring procedures in place to make sure that the criteria used to identify significant increases in credit are effective, meaning that significant increase in credit risk is identified before the exposure is defaulted or when the asset becomes 30 days past due. The Bank performs periodic back-testing of its ratings to consider whether the drivers of credit risk that led to default were accurately reflected in the rating in a timely manner.

The Bank has controls and procedures in place to identify when the credit risk of an asset improves and the definition of significant increase in credit risk is no longer met. When this is the case the asset may move back to stage 1 from stage 2, subject to payments being up to date and the ability of the borrower to make future payments on time.

##### Incorporation of forward-looking information

The Bank uses forward-looking information that is available without undue cost or effort in its assessment of significant increase of credit risk as well as in its measurement of ECL. The Bank uses internal experts who use external and internal information to generate a 'base case' scenario of future forecast of relevant economic variables along with a representative range of other possible forecast scenarios. The external information used includes economic data and forecasts published by governmental bodies and monetary authorities.

The Bank uses multiple scenarios to model the non-linear impact of assumptions about macroeconomic factors on ECL. The Bank applies probabilities to the forecast scenarios identified. The base case scenario is the single most-likely outcome and consists of information used by the Bank for strategic planning and budgeting. The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The Bank has not made changes in the estimation techniques or significant assumptions made during the reporting period.

##### Measurement of ECL

The key inputs used for measuring ECL are:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

As explained above these figures are generally derived from internally developed statistical models and other historical data and they are adjusted to reflect probability-weighted forward-looking information.

PD is an estimate of the likelihood of default over a given time horizon. It is estimated as at a point in time. The calculation is based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Measurement of ECL (Continued)

models are based on market data (where available), as well as internal data comprising both quantitative and qualitative factors. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to take into account estimates of future conditions that will impact PD.

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross collateralisation and seniority of claim, cost of realisation of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original EIR of the loan.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities. The Bank's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortisation profiles, early repayment or overpayment, changes in utilisation of undrawn commitments and credit mitigation actions taken before default. The Group uses EAD models that reflect the characteristics of the portfolios.

The Bank measures ECL considering the risk of default over the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if contact extension or renewal is common business practice. For such financial instruments the Bank measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. These financial instruments do not have a fixed term or repayment structure and have a short contractual cancellation period. However, the Bank does not enforce in the normal day-to-day management the contractual right to cancel these financial instruments. This is because these financial instruments are managed on a collective basis and are cancelled only when the Bank becomes aware of an increase in credit risk at the

facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment.

The measurement of ECL is based on probability weighted average credit loss. As a result, the measurement of the loss allowance should be the same regardless of whether it is measured on an individual basis or a collective basis (although measurement on a collective basis is more practical for large portfolios of items). In relation to the assessment of whether there has been a significant increase in credit risk it can be necessary to perform the assessment on a collective basis as noted below on Groupings based on shared risks characteristics.

##### Groupings based on shared risks characteristics

When ECL are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics, such as:

- instrument type;
- credit risk grade;
- collateral type;
- date of initial recognition;
- remaining term to maturity;
- industry;
- geographic location of the borrower;
- income bracket of the borrower; and

The groupings are reviewed on a regular basis to ensure that each group is comprised of homogenous exposures.

##### Credit quality

The Bank monitors credit risk per class of financial instrument. An analysis of the Bank's credit risk concentrations per class of financial asset is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

##### (i) Management of credit risk

##### Concentrations of assets:

Details of significant concentrations of the company's financial assets and liabilities by industry groups are as detailed below:

	2019 Shs '000	%	2018 Shs '000	%
<b>Principal loans to customers</b>				
Agriculture	697,705	3%	704,659	4%
Trade	6,024,560	27%	7,715,557	38%
Consumer	15,527,493	70%	11,799,240	58%
	<b>22,249,758</b>	<b>100%</b>	<b>20,219,456</b>	<b>100%</b>
<b>Cash collaterals</b>				
Agriculture	20,910	4%	26,775	5%
Trade	457,086	93%	549,195	93%
Consumer	13,067	3%	12,873	2%
	<b>491,063</b>	<b>100%</b>	<b>588,843</b>	<b>100%</b>

##### (ii) Maximum exposure to credit risk before collateral held

	2019 Shs '000	%	2018 Shs '000	%
<b>Credit exposure on balance sheet items:</b>				
Short term deposits with banks	1,349,703	5	1,968,670	8
Loans to customers	22,249,758	78	20,219,457	79
Government securities	3,500,000	12	1,900,000	7
Bank balances	285,798	1	677,926	3
Cash balances with Central Bank of Kenya	1,019,104	4	1,029,133	4
<b>Total gross carrying amount</b>	<b>28,404,363</b>	<b>100</b>	<b>25,795,186</b>	<b>100%</b>
<b>Allowance for credit losses (Note 11(b))</b>	<b>(2,518,708)</b>		<b>(2,286,639)</b>	
<b>Net carrying amount</b>	<b>25,885,655</b>		<b>23,508,547</b>	

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

An analysis of the Banks's credit risk exposure per class of financial asset, internal rating and "stage" without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

##### 31 December 2019

	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loans and advances to customers at amortised cost</b>				
Grade 1: Normal	17,622,630	60,989	4,574	17,688,194
Grade 2: Watch	710,584	80,872	14,298	805,753
Grade 3: Substandard	-	371,061	2,050	373,111
Grade 4: Doubtful	-	211,292	2,804	214,096
Grade 5: Loss	-	-	1,974,419	1,974,419
<b>Total gross carrying amount</b>	<b>18,333,214</b>	<b>724,215</b>	<b>1,998,144</b>	<b>21,055,573</b>
Allowance for credit losses	(434,177)	(208,484)	(1,830,355)	(2,473,016)
<b>Net carrying amount</b>	<b>17,899,037</b>	<b>515,731</b>	<b>167,789</b>	<b>18,582,557</b>

##### 31 December 2018

	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loans and advances to customers at amortised cost</b>				
Grade 1: Normal	13,902,359	153,242	62,986	14,118,587
Grade 2: Watch	2,163,541	344,323	46,868	2,554,732
Grade 3: Substandard	-	377,035	10,727	387,762
Grade 4: Doubtful	-	168,593	16,443	185,036
Grade 5: Loss	-	-	1,934,406	1,934,406
<b>Total gross carrying amount</b>	<b>16,065,900</b>	<b>1,043,193</b>	<b>2,071,430</b>	<b>19,180,523</b>
Allowance for credit losses	(549,750)	(257,459)	(1,438,560)	(2,245,769)
<b>Net carrying amount</b>	<b>15,516,150</b>	<b>785,734</b>	<b>632,870</b>	<b>16,934,754</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the loss allowance during the year per class of assets.

##### 31 December 2019

Loss allowance - Loans and advances to customers at amortized cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loss allowance as at 1 January 2019</b>	<b>(549,750)</b>	<b>(257,459)</b>	<b>(1,438,560)</b>	<b>(2,245,769)</b>
<b>Amount charged to P&amp;L (sub-total)</b>	<b>115,574</b>	<b>48,975</b>	<b>(722,440)</b>	<b>(557,891)</b>
Originations, purchases and interest accruals	(276,628)	(108,556)	(106,468)	(491,652)
Repayments & other derecognitions, excluding write-offs	60,624	89,881	106,424	256,929
Changes in the loss allowance				
-Transfer to stage 1	(82,598)	25,410	13,013	(44,175)
-Transfer to stage 2	61,632	(91,626)	45,736	15,742
-Transfer to stage 3	243,991	186,136	(650,039)	(219,912)
-Changes due to modification that did not result in derecognition.	-	-	-	-
-Changes to model and risk parameters used for ECL calculations	108,554	(52,271)	(131,105)	(74,822)
Write-offs	-	-	330,645	330,645
<b>Loss allowance as at 31 December 2019</b>	<b>(434,177)</b>	<b>(208,484)</b>	<b>(1,830,355)</b>	<b>(2,473,016)</b>

##### 31 December 2018

Loss allowance- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loss allowance as at 1 January 2018</b>	<b>(457,589)</b>	<b>(568,436)</b>	<b>(1,163,687)</b>	<b>(2,189,712)</b>
Changes in the loss allowance				
-Transfer to stage 1	(247,901)	174,087	73,814	-
-Transfer to stage 2	38,543	(61,427)	22,883	-
-Transfer to stage 3	25,432	147,012	(172,444)	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
Write-offs	-	-	58,493	58,493
New financial assets originated or purchased	(528,613)	-	-	(528,613)
Financial assets that have been derecognised	620,377	51,304	(257,619)	414,062
<b>Loss allowance as at 31 December 2018</b>	<b>(549,751)</b>	<b>(257,460)</b>	<b>(1,438,560)</b>	<b>(2,245,770)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the loss allowance during the year per class of assets.

##### 31 December 2019

Loss allowance- Other financial assets at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loss allowance as at 1 January 2019</b>	<b>(26,035)</b>	<b>(4,343)</b>	<b>(10,208)</b>	<b>(40,586)</b>
Changes in the loss allowance				
-Transfer to stage 1	-	-	-	-
-Transfer to stage 2	-	-	-	-
-Transfer to stage 3	-	-	-	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	-	-
New financial assets originated or purchased	(5,855)	-	(3,466)	(5,160)
Financial assets that have been derecognised	53	4,161	-	4,214
<b>Loss allowance as at 31 December 2019</b>	<b>(31,837)</b>	<b>(182)</b>	<b>(13,674)</b>	<b>(45,693)</b>

##### 31 December 2018

Loss allowance- Other financial assets at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Loss allowance as at 1 January 2019</b>	<b>(30,198)</b>	<b>(16,368)</b>	<b>-</b>	<b>(46,566)</b>
Changes in the loss allowance				
-Transfer to stage 1	(16,368)	16,368	-	-
-Transfer to stage 2	-	-	-	-
-Transfer to stage 3	-	-	-	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	-	-
New financial assets originated or purchased	(15,892)	-	(15,029)	(30,921)
Financial assets that have been derecognised	36,901	-	-	36,901
<b>Loss allowance as at 31 December 2019</b>	<b>(25,557)</b>	<b>-</b>	<b>(15,029)</b>	<b>(40,586)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the gross carrying amount during the year per class of assets.

##### 31 December 2019

Banking Gross carrying amounts- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Gross carrying as at 1 January 2019</b>	<b>16,648,996</b>	<b>1,072,256</b>	<b>2,498,204</b>	<b>20,219,456</b>
Changes in the loss allowance				
-Transfer to stage 1	697,519	(466,004)	(231,515)	-
-Transfer to stage 2	(236,610)	499,058	(262,448)	-
-Transfer to stage 3	(1,119,168)	(424,286)	1,543,454	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	(330,645)	(330,645)
New financial assets originated or purchased	10,630,612	279,177	115,669	11,025,458
Financial assets that have been derecognised	(8,009,499)	(207,315)	(447,698)	(8,664,512)
<b>Gross carrying amounts as at 31 December 2019</b>	<b>18,611,850</b>	<b>752,886</b>	<b>2,885,021</b>	<b>22,249,757</b>

##### 31 December 2018

Banking Gross carrying amounts- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Gross carrying as at 1 January 2018</b>	<b>14,573,930</b>	<b>1,081,039</b>	<b>2,163,160</b>	<b>17,818,129</b>
Changes in the loss allowance				
-Transfer to stage 1	913,770	(657,415)	(256,355)	-
-Transfer to stage 2	(663,213)	722,186	(58,973)	-
-Transfer to stage 3	(1,092,963)	(141,289)	1,234,252	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	58,493	58,493
New financial assets originated or purchased	10,295,592	570,531	338,686	11,204,809
Financial assets that have been derecognised	(7,378,121)	(502,795)	(981,059)	(8,861,975)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>16,648,995</b>	<b>1,072,257</b>	<b>2,498,204</b>	<b>20,219,456</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the gross carrying amount during the year per product.

##### 31 December 2019

Gross carrying amounts- Loans and advances to customers at amortized cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>SME</b>				
<b>Gross carrying as at 1 January 2018</b>	<b>2,416,416</b>	<b>498,051</b>	<b>1,490,186</b>	<b>4,404,653</b>
-Transfer to stage 1	263,914	(215,288)	(48,626)	-
-Transfer to stage 2	(20,893)	163,386	(142,493)	-
-Transfer to stage 3	(686,388)	(108,842)	795,230	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	(173,276)	(173,276)
New financial assets originated or purchased	810,866	36,050	2,718	849,635
Financial assets that have been derecognized	(947,339)	(95,356)	(346,218)	(1,388,913)
<b>Gross carrying amounts as at 31 December 2019</b>	<b>1,836,576</b>	<b>278,001</b>	<b>1,577,521</b>	<b>3,692,099</b>
<b>Community</b>				
<b>Gross carrying as at 1 January 2018</b>	<b>1,359,659</b>	<b>197,341</b>	<b>559,198</b>	<b>2,116,198</b>
-Transfer to stage 1	219,111	(136,782)	(82,329)	-
-Transfer to stage 2	(47,842)	97,792	(49,950)	-
-Transfer to stage 3	(160,940)	(73,204)	234,144	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	(33,865)	(33,865)
New financial assets originated or purchased	1,461,646	150,370	69,535	1,681,551
Financial assets that have been derecognized	(1,077,181)	17,276	(51,330)	(1,111,235)
<b>Gross carrying amounts as at 31 December 2019</b>	<b>1,754,453</b>	<b>252,793</b>	<b>645,403</b>	<b>2,652,649</b>

Gross carrying amounts- Loans and advances to customers at amortized cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Retail</b>				
<b>Gross carrying as at 1 January 2018</b>	<b>12,872,921</b>	<b>376,864</b>	<b>448,820</b>	<b>13,698,605</b>
-Transfer to stage 1	214,494	(113,934)	(100,560)	-
-Transfer to stage 2	(167,875)	237,880	(70,005)	-
-Transfer to stage 3	(271,840)	(242,240)	514,080	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	(123,504)	(123,504)
New financial assets originated or purchased	8,358,100	92,757	43,416	8,494,273
Financial assets that have been derecognized	(5,984,979)	(129,235)	(50,150)	(6,164,364)
<b>Gross carrying amounts as at 31 December 2019</b>	<b>15,020,821</b>	<b>222,092</b>	<b>662,097</b>	<b>15,905,010</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the credit loss allowance amount during the year per product.

##### 31 December 2019

Loss allowance- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>SME</b>				
<b>Loss allowance as at 1 January 2019</b>	<b>(42,330)</b>	<b>(82,347)</b>	<b>(737,787)</b>	<b>(862,464)</b>
Amount charged to P&L (sub-total)	32,109	60,390	(279,827)	(187,328)
Originations, purchases and interest accruals	(6,509)	(1,914)	(1,914)	(10,337)
Repayments & other derecognitions, excl write-offs	10,101	7,739	39,894	57,734
Changes in the loss allowance				
-Transfer to stage 1	(57,036)	14,861	435	(41,740)
-Transfer to stage 2	2,568	(20,082)	17,514	-
-Transfer to stage 3	35,167	86,825	(258,757)	(136,765)
-Changes to model and risk parameters used for ECL calculations	47,818	(27,039)	(76,999)	(56,220)
-Write-offs	-	-	173,276	173,276
<b>Loss allowance as at 31 December 2019</b>	<b>(10,221)</b>	<b>(21,957)</b>	<b>(844,338)</b>	<b>(876,516)</b>
<b>Community</b>				
<b>Loss allowance as at 1 January 2019</b>	<b>(97,622)</b>	<b>(26,785)</b>	<b>(223,321)</b>	<b>(347,728)</b>
Amount charged to P&L (sub-total)	(18,804)	(45,078)	(214,021)	(277,903)
Originations, purchases and interest accruals	(87,386)	(57,285)	(59,678)	(204,349)
Repayments & other derecognitions, excl write-offs	37,469	6,113	11,558	55,140
Changes in the loss allowance				
-Transfer to stage 1	(18,682)	9,273	9,408	(1)
-Transfer to stage 2	13,600	(39,875)	14,199	(12,076)
-Transfer to stage 3	33,727	45,764	(146,376)	(66,885)
-Changes to model and risk parameters used for ECL calculations	2,468	(9,068)	(43,132)	(49,732)
-Write-offs	-	-	33,865	33,865
<b>Loss allowance as at 31 December 2019</b>	<b>(116,426)</b>	<b>(71,863)</b>	<b>(403,477)</b>	<b>(591,766)</b>

Loss allowance- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Retail</b>				
<b>Loss allowance as at 1 January 2019</b>	<b>(409,798)</b>	<b>(148,326)</b>	<b>(477,451)</b>	<b>(1,035,575)</b>
Amount charged to P&L (sub-total)	102,271	33,662	(228,594)	(92,661)
Originations, purchases and interest accruals	(182,732)	(49,358)	(44,877)	(276,967)
Repayments & other derecognitions, excl write-offs	13,054	76,029	54,972	144,055
Changes in the loss allowance				
-Transfer to stage 1	(6,880)	1,276	3,169	(2,435)
-Transfer to stage 2	45,464	(31,669)	14,022	27,817
-Transfer to stage 3	175,097	53,548	(244,906)	(16,261)
-Changes to model and risk parameters used for ECL calculations	58,268	(16,164)	(10,974)	31,130
-Write-offs	-	-	123,504	123,504
<b>Loss allowance as at 31 December 2019</b>	<b>(307,527)</b>	<b>(114,664)</b>	<b>(582,541)</b>	<b>(1,004,732)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

The tables below analyse the movement of the credit loss allowance amount during the year per product.

##### 31 December 2019

Loss allowance- Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>SME</b>				
<b>Loss allowance as at 1 January 2018</b>	<b>(113,842)</b>	<b>(247,556)</b>	<b>(607,068)</b>	<b>(968,466)</b>
Changes in the loss allowance	-	-	-	-
-Transfer to stage 1	(64,011)	43,998	20,014	-
-Transfer to stage 2	13,994	(26,604)	12,610	-
-Transfer to stage 3	7,071	61,651	(68,721)	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	46,951	46,951
New financial assets originated or purchased	(70,735)	-	-	(70,735)
Financial assets that have been derecognised	185,194	86,164	(141,572)	129,786
<b>Loss allowance as at 31 December 2018</b>	<b>(42,330)</b>	<b>(82,347)</b>	<b>(737,787)</b>	<b>(862,464)</b>
<b>Community</b>				
<b>Loss allowance as at 1 January 2018</b>	<b>(49,659)</b>	<b>(37,017)</b>	<b>(78,332)</b>	<b>(165,008)</b>
Changes in the loss allowance	-	-	-	-
-Transfer to stage 1	(29,947)	20,295	9,652	-
-Transfer to stage 2	1,303	(4,206)	2,904	-
-Transfer to stage 3	82	54	(136)	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	-	-
New financial assets originated or purchased	(26,924)	(2,232)	(16,764)	(45,920)
Financial assets that have been derecognised	7,524	(3,678)	(140,645)	(136,800)
<b>Loss allowance as at 31 December 2018</b>	<b>(97,622)</b>	<b>(26,785)</b>	<b>(223,321)</b>	<b>(347,728)</b>

Gross carrying amounts- Loans and advances to customers at amortized cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	Total Sh'000
<b>Retail</b>				
<b>Loss allowance as at 1 January 2018</b>	<b>(294,088)</b>	<b>(283,863)</b>	<b>(478,286)</b>	<b>(1,056,237)</b>
Changes in the loss allowance	-	-	-	-
-Transfer to stage 1	(153,942)	109,794	44,148	-
-Transfer to stage 2	23,246	(30,616)	7,370	-
-Transfer to stage 3	18,279	85,307	(103,587)	-
-Increases due to change in credit risk	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-
-Write-offs	-	-	11,542	11,542
New financial assets originated or purchased	(411,958)	-	-	(411,958)
Financial assets that have been derecognised	408,664	(28,949)	41,362	421,078
<b>Loss allowance as at 31 December 2018</b>	<b>(409,798)</b>	<b>(148,326)</b>	<b>(477,451)</b>	<b>(1,035,575)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### a) Credit risk (Continued)

##### Credit quality (continued)

As discussed above in the significant increase in credit risk section, under the Bank's monitoring procedures a significant increase in credit risk is identified before the exposure has defaulted, and at the latest when the exposure becomes 30 days past due. The table below provides an analysis of the gross carrying amount of loans and advances to customers by past due status.

##### Loans to customers

	Gross Shs '000	Net Shs '000
<b>31 December 2019</b>		
IFRS 9 Stage 1 (0- 30 days)	18,611,850	18,177,673
IFRS 9 Stage 2 (31- 90 days)	752,886	544,403
IFRS 9 Stage 3 (Over 90 days)	2,885,021	1,054,666
	<b>22,249,757</b>	<b>19,776,742</b>
<b>31 December 2018</b>		
Neither past due nor impaired (0-30 days)	16,648,995	16,099,244
Past due but not impaired (31-90 days)	1,072,256	814,799
Impaired (Over 90 days)	2,498,205	1,059,645
	<b>20,219,456</b>	<b>17,973,688</b>

##### Cash Collateral held

The Bank's cash collateral consists of collateral held against loans and receivables to group customers (note 23). The fair value of cash collateral is Shs 491,063,000 (2018: Shs 588,844,000).

#### b) Liquidity risk

The group is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

##### (i) Management of liquidity risk

The group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the company's reputation. The Risk Compliance and Credit Committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties meeting financial liabilities as they fall due is encountered.

A portfolio of short-term liquid assets largely made up of short-term liquid investment securities and bank facilities ensure that sufficient liquidity is maintained within the Bank as a whole. The liquidity ratio as at 31 December 2019 was 26.5% (2018:26.6%). The Central Bank of Kenya liquidity regulatory requirement is 20%.

##### (ii) Source of funding

The company has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base of customers. The group also borrows from the banks for short term liquidity requirements.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### b) Liquidity risk (continued)

As at December 2019	Maturing in less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Total Shs '000
<b>FINANCIAL LIABILITIES</b>								
Cash collateral held	17,061	76,176	31,984	76,848	171,028	92,646	25,321	<b>491,063</b>
Borrowings	65,464	437,272	760,397	972,334	2,130,808	-	-	<b>4,366,275</b>
Customer deposits	3,801,661	7,547,406	4,663,993	3,281,305	224,375	-	-	<b>19,538,740</b>
<b>Total liabilities (contractual maturity dates)</b>	<b>3,884,186</b>	<b>8,080,854</b>	<b>5,456,374</b>	<b>4,330,487</b>	<b>2,526,211</b>	<b>92,646</b>	<b>25,321</b>	<b>24,376,079</b>
<b>FINANCIAL ASSETS</b>								
Cash and bank balances	620,888	-	-	-	-	-	-	<b>620,888</b>
Short term deposits	400,000	838,303	-	55,175	56,225	-	-	<b>1,349,703</b>
Cash reserve requirement	1,019,103	-	-	-	-	-	-	<b>1,019,103</b>
Government securities	100,000	600,000	450,000	250,000	300,000	-	1,769,378	<b>3,469,738</b>
Loans to customers (net)	757,242	1,818,315	1,469,978	2,456,727	6,161,671	4,635,367	2,477,442	<b>19,776,742</b>
<b>Total assets (expected maturity dates)</b>	<b>2,897,233</b>	<b>3,256,618</b>	<b>1,919,978</b>	<b>2,761,902</b>	<b>6,517,896</b>	<b>4,635,367</b>	<b>4,246,820</b>	<b>26,235,814</b>
<b>NET LIQUIDITY GAP</b>	<b>(986,953)</b>	<b>(4,824,236)</b>	<b>(3,536,396)</b>	<b>(1,568,585)</b>	<b>3,991,685</b>	<b>4,542,721</b>	<b>4,221,499</b>	<b>1,375,587</b>
<b>As at 31 December 2018</b>								
Total liabilities (contractual maturity dates)	8,731,467	5,526,227	2,480,660	2,167,738	594,437	474,994	46,354	<b>20,021,877</b>
Total assets (expected maturity dates)	3,231,255	2,742,927	561,963	944,024	5,742,415	5,483,764	2,939,016	<b>21,645,364</b>
<b>NET LIQUIDITY GAP</b>	<b>(5,500,212)</b>	<b>(2,783,300)</b>	<b>(1,918,697)</b>	<b>(1,223,714)</b>	<b>5,147,978</b>	<b>5,008,770</b>	<b>2,892,662</b>	<b>1,623,487</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### c) Market Risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads will affect the company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

#### Management of market risks

Overall authority for market risk is vested in the Risk Compliance and Credit Committee which is responsible for the development of detailed risk management policies. The policies are subject to review and approval by the board.

#### Exposure to interest rate risk

The company is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on financial position and cash flows. The risk committee closely monitors the interest rates trends to minimize the potential adverse impact of interest rate changes. The table overleaf summarizes the exposure of interest rate risk at the end of reporting period. The company maintains an appropriate mix of fixed and floating rates deposit base. Interest rates on advances to customers and other risk assets are either pegged to the company's lending rate or the company's rates are adjusted from time to time to reflect the cost of deposits.

Interest rates on cash collateral held are determined by the company with the company retaining the discretion to adjust the rates in line with changes in market trends. The interest rates, therefore, may fluctuate depending on the movement in the market interest rates. The company also invests in fixed interest rate instruments issued by the Government of Kenya through the Central Bank of Kenya.

The matching and controlled mismatching of the maturities and interest rate of assets and liabilities is fundamental to the management of the company. It is unusual for a company's assets and liabilities to be completely matched due to the nature of business terms and types.

Included in the table overleaf are financial assets and liabilities at carrying amounts categorized by the earlier of contractual repricing or maturity dates.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### c) Market risks (continued)

The table below summarises the exposure to interest rate risks. Included in the table are the group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The group does not bear an interest rate risk on off statement of financial position items. (All figures are in Kenya Shillings).

	Less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Non-interest bearing Shs '000	Total Shs '000
<b>A. FINANCIAL ASSETS</b>									
Cash and bank balances	620,888	-	-	-	-	-	-	-	<b>620,888</b>
Short term deposits	400,000	838,303	-	55,175	56,225	-	-	-	<b>1,349,703</b>
Cash reserve ratio (CBK)	-	-	-	-	-	-	-	1,019,103	<b>1,019,103</b>
Government securities	100,000	600,000	450,000	250,000	300,000	-	1,769,378	-	<b>3,469,378</b>
Loans to customers (net)	752,242	1,818,315	1,469,978	2,456,727	6,161,671	4,635,367	2,477,442	-	<b>19,776,742</b>
<b>Total financial assets</b>	<b>1,873,130</b>	<b>3,256,618</b>	<b>1,919,978</b>	<b>2,761,902</b>	<b>6,517,896</b>	<b>4,635,367</b>	<b>4,246,820</b>	<b>1,019,103</b>	<b>26,235,814</b>
<b>B. FINANCIAL LIABILITIES</b>									
Borrowings	65,464	437,272	760,397	972,334	2,130,808	-	-	-	<b>4,366,275</b>
Customer deposits	3,801,661	7,567,406	4,663,993	3,281,305	224,375	-	-	-	<b>19,538,740</b>
Cash collateral held	-	-	-	-	-	-	-	491,063	<b>491,063</b>
<b>Total financial liabilities</b>	<b>3,867,125</b>	<b>8,004,678</b>	<b>5,424,390</b>	<b>4,253,639</b>	<b>2,355,183</b>	<b>-</b>	<b>-</b>	<b>491,063</b>	<b>24,396,078</b>
<b>C. On statement of financial position-interest sensitivity gap</b>	<b>(1,993,995)</b>	<b>(4,748,060)</b>	<b>(3,504,412)</b>	<b>(1,491,737)</b>	<b>4,162,713</b>	<b>4,653,367</b>	<b>4,246,820</b>	<b>528,040</b>	<b>1,839,736</b>
<b>D. As at 31 December 2018</b>									
Total financial assets	2,725,142	2,351,252	1,468,740	958,234	3,615,880	2,015,501	8,670,544	1,029,133	<b>22,834,426</b>
Total financial liabilities	7,233,604	6,039,813	3,429,534	2,806,949	1,672,327	1,189,261	-	588,843	<b>22,960,331</b>
<b>E. On statement of financial position- interest sensitivity gap</b>	<b>(4,508,462)</b>	<b>(3,688,561)</b>	<b>(1,960,794)</b>	<b>(1,848,715)</b>	<b>1,943,553</b>	<b>826,240</b>	<b>8,670,544</b>	<b>440,290</b>	<b>(125,905)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### c) Market risks (continued)

##### Interest rate risk stress test

The impact that an immediate hypothetical increase or decrease in interest rates of 3% applied at the beginning of the year would have on the profit for the year assuming a growing balance sheet and current interest rate risk profile would be as follows:

		2019		2018
	Effect on profit	Shs '000	Effect on equity	Shs '000
3% increase in interest rates	71,555	50,088	56,533	39,573
3% decrease in interest rates	(71,555)	(50,088)	(56,533)	(39,573)

The model does not take into account any corrective action in response to interest rate movements, particularly in adverse situations.

##### Currency risk

The company operates wholly within Kenya and its assets and liabilities are reported in the local currency.

The company's currency position is as follows and all amounts are stated in Shs.

	Shs '000	USD	Euro	GBP	Total Shs '000'
<b>A. ASSETS</b>					
Cash and bank balances	614,241	348	2,789	3,522	<b>620,888</b>
Short term deposits with banks	911,399	-	-	438,303	<b>1,349,702</b>
Cash reserve ratio (CBK)	1,019,103	-	-	-	<b>1,019,103</b>
Government securities	3,469,378	-	-	-	<b>3,469,378</b>
Loans to customers (net)	19,776,742	-	-	-	<b>19,776,742</b>
<b>Total financial assets</b>	<b>25,790,863</b>	<b>348</b>	<b>2,777</b>	<b>441,825</b>	<b>26,235,813</b>
<b>B. LIABILITIES</b>					
Cash collateral held	491,063	-	-	-	<b>491,063</b>
Borrowings	4,366,275	-	-	-	<b>4,366,275</b>
Customer deposits	19,538,740	-	-	-	<b>19,538,740</b>
<b>Total financial liabilities</b>	<b>24,396,078</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>24,396,078</b>
<b>C NET BALANCE SHEET POSITION</b>	<b>1,394,785</b>	<b>348</b>	<b>2,777</b>	<b>441,825</b>	<b>1,839,735</b>
<b>As at 31 December 2018</b>					
<b>A Total financial assets</b>	<b>23,013,972</b>	<b>2,789</b>	<b>81,481</b>	<b>440,000</b>	<b>23,076,005</b>
<b>B Total financial liabilities</b>	<b>22,960,332</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>22,960,332</b>
<b>C NET BALANCE SHEET POSITION</b>	<b>53,640</b>	<b>2,789</b>	<b>81,481</b>	<b>440,000</b>	<b>115,673</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### c) Market risks (Continued)

The table below summarizes the estimated impact of a 10% decline/appreciation of the Kenya Shilling against the two major currencies traded by the company i.e. the US Dollar and the Euro.

	2019 Shs '000 Effect on profit	2018 Shs '000 Effect on profit
<b>Currency – Euro</b>		
+ 10% Shs movement	(278)	(8,148)
- 10% Shs movement	278	8,148
<b>Currency - US dollars</b>		
+ 10% Shs movement	(35)	(279)
- 10% Shs movement	35	279
<b>Currency – GBP</b>		
+ 10% Shs movement	(44,183)	(44,000)
- 10% Shs movement	44,183	44,000

### 4. CAPITAL RISK MANAGEMENT

The Central Bank of Kenya sets and monitors capital requirements for microfinance banks.

The Microfinance bank regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Various limits are applied to elements of the capital base. Qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 % of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of Microfinance bank and certain other regulatory items.

Risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-statement of financial position exposures.

The institution's aim is to build a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Microfinance bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 4. CAPITAL RISK MANAGEMENT

In implementing current capital requirements, the Central Bank of Kenya requires each microfinance bank to maintain;

- A minimum level of regulatory capital of Shs 60 million.
- A ratio of core capital to the risk-weighted assets plus risk-weighted off-statement of financial position assets at or above the required minimum of 10%.
- Core capital of not less than 8% of total deposit liabilities.
- Supplementary capital of not less than 12% of risk-weighted assets plus risk-weighted off-statement of financial position items.

Faulu Microfinance Bank Limited has complied with all externally imposed capital requirements throughout the year.

The capital position at 31 December was as follows;

	BANK	
	2019 Shs '000	2018 Shs '000
<b>Tier 1 capital</b>		
Share capital	480,000	480,000
Share premium	2,899,759	2,899,759
Retained earnings / (accumulated deficit)	141,430	(171,384)
	<b>3,521,189</b>	<b>3,208,375</b>
<b>Tier 2 capital</b>		
Revaluation reserve	63,663	63,876
	<b>63,663</b>	<b>63,876</b>
<b>Regulatory capital</b>	<b>3,584,852</b>	<b>3,272,251</b>
<b>Total risk-weighted assets</b>	<b>22,208,223</b>	<b>20,462,843</b>
<b>Borrowings</b>	<b>4,366,275</b>	<b>4,430,520</b>
<b>Capital ratios</b>		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum -12%)	15.3%	16.9%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum -10%)	15.0%	16.6%

The Insurance Regulatory Authority (IRA) requires each insurance broker and agency to maintain a minimum level of regulatory capital of Shs 1,000,000. As at 31 December 2019, the subsidiary Faulu MFB Insurance Agency Limited had a capital of Shs 48,527,000 (2018 Shs 30,359,000).

#### Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk and Compliance and Credit, and is subject to review by the Board Credit Committee or ALCO as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Microfinance bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with Microfinance Bank's longer term strategic objectives. The Microfinance bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 5. INTEREST INCOME

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Loans and receivables	4,340,080	3,570,948
Short term bank deposits	137,748	163,237
Government securities	392,559	311,444
	<b>4,870,387</b>	<b>4,045,629</b>

### 6. INTEREST EXPENSE

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Interest on customer deposits	1,744,451	1,626,553
Interest on bank loans	510,240	487,800
Interest on lease liability	46,030	-
	<b>2,300,721</b>	<b>2,114,353</b>

### 7. FEES AND COMMISSIONS

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
Registration fees	541	389	540	389
Loan set up fees	380,797	370,639	380,797	368,635
Commission (net)	164,928	183,899	133,083	158,505
Chattels mortgage fees	19,847	12,067	19,847	12,067
	<b>566,113</b>	<b>566,994</b>	<b>534,267</b>	<b>539,596</b>

### 8. OTHER OPERATING INCOME

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
Bad debts recovered	32,502	1,644	32,503	1,644
Other income	5,137	21,252	830	17,371
	<b>37,639</b>	<b>22,896</b>	<b>33,333</b>	<b>19,015</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 9. ADMINISTRATION AND OPERATING EXPENSES

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Staff costs (note 10)	915,502	968,567	908,785	957,806
Office operations and supplies	565,557	518,336	565,486	517,412
Training and evaluation	10,850	7,988	10,850	7,988
Office rent and repairs	8,673	181,194	8,673	181,194
Travelling expenses	33,262	41,794	33,263	41,794
Depreciation of property and equipment	131,589	144,219	131,494	144,297
Depreciation on right-of use-of asset	124,250	-	124,250	-
Audit fees	6,130	5,200	5,780	4,795
Loss on disposal of a motor vehicle	16,609	3,147	16,609	3,147
Amortisation of intangible assets	176,022	188,579	176,022	188,579
Directors' fees	14,734	14,487	14,032	13,490
Other expenses	99,566	51,852	96,191	48,879
Assets written off	30,217	3,147	30,217	3,147
	<b>2,132,961</b>	<b>2,128,510</b>	<b>2,121,652</b>	<b>2,112,528</b>

### 10. STAFF COSTS

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Staff salaries and wages	680,650	808,883	673,933	798,122
Medical expenses	91,133	112,404	91,133	112,404
Defined contribution pension scheme	56,680	61,080	56,680	61,080
Statutory pension contribution (NSSF)	1,081	1,407	1,081	1,407
Recruitment	1,367	967	1,367	967
Staff welfare & entertainment	6,257	8,544	6,257	8,544
Staff bonus	80,348	(33,488)	80,348	(33,488)
Leave (credit)/ charge	(5,570)	5,964	(5,570)	5,964
Staff welfare-other	3,556	2,806	3,556	2,806
	<b>915,502</b>	<b>968,567</b>	<b>908,785</b>	<b>957,806</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 11. a) IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
At 1 January	2,288,191	2,237,277	2,286,639	2,237,277
Additional provision during the year	561,610	109,407	562,714	107,855
Loans written off during the year	(330,645)	(58,493)	(330,645)	(58,493)
<b>At 31 December</b>	<b>2,519,156</b>	<b>2,288,191</b>	<b>2,518,708</b>	<b>2,286,639</b>

b) The closing balance as at 31 December is split as follows:

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
Loans to customers	2,473,016	2,245,769	2,473,016	2,245,769
Cash balances with Central Bank of Kenya	34	34	34	34
Short term deposits banks	1,047	5,224	1,047	5,224
Government securities	30,662	20,100	30,662	20,100
Other assets	14,397	16,663	13,949	15,512
	<b>2,519,156</b>	<b>2,288,191</b>	<b>2,518,708</b>	<b>2,286,639</b>

### 12. TAXATION

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
a) Taxation Charge				
Current tax expense				
Based on the adjusted profit for the year at 30%	275,231	116,405	267,775	111,748
Share of associate company taxation (note 18)	692	1,389	692	1,389
Current tax expense	275,923	117,794	268,467	113,137
Deferred tax credit (note 19)	(123,630)	(20,878)	(123,958)	(20,428)
Prior under provision of deferred tax asset (note 19)	(5)	-	-	-
<b>Tax charge</b>	<b>152,288</b>	<b>96,916</b>	<b>144,509</b>	<b>92,709</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 12 TAXATION (Continued)

b) The closing balance as at 31 December is split as follows:

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Accounting profit before taxation	482,419	287,360	456,472	273,615
Tax at the applicable rate of 30%	144,726	86,208	136,942	82,085
Tax effect of expenses not deductible for tax purposes	6,875	9,569	6,875	9,235
Prior under provision of deferred tax asset (note 19)	(5)	-	-	-
	<b>151,596</b>	<b>95,777</b>	<b>143,817</b>	<b>91,320</b>
Share of associate company taxation (note 18)	692	1,139	692	1,139
	<b>152,288</b>	<b>96,916</b>	<b>144,509</b>	<b>92,709</b>
c) Tax payable / (recoverable)				
At 1 January	(166,634)	(237,123)	(167,935)	(237,739)
Charge for the year	275,231	116,405	267,775	111,748
Paid in the year	(60,473)	(45,916)	(54,028)	(41,944)
<b>At 31 December</b>	<b>48,124</b>	<b>(166,634)</b>	<b>45,812</b>	<b>(167,935)</b>
Tax recoverable	-	(167,935)	-	(167,935)
Tax payable	48,124	1,301	45,812	-
	<b>48,124</b>	<b>(166,634)</b>	<b>45,812</b>	<b>(167,935)</b>

### 13. SHORT TERM DEPOSITS WITH BANKS

	GROUP AND BANK	
	2019 Shs '000	2018 Shs '000
<b>Amortized cost</b>		
The Co-operative Bank of Kenya Limited	100,000	500,000
Kenya Commercial Bank PLC	500,000	700,000
Equity Bank PLC	-	100,000
Absa Bank Kenya PLC	200,000	-
Stanbic Bank Kenya Limited	438,303	500,000
SBM Bank Limited	112,446	168,670
	<b>1,350,749</b>	<b>1,968,670</b>
Less: allowance for credit losses (Note (11 (b)))	(1,047)	(5,224)
	<b>1,349,702</b>	<b>1,963,446</b>

Effective interest rate average 7.2% in 2019 and 8.8% in 2018. All the deposits except those held by SBM Bank mature within 90 days from the balance sheet date. The deposits held with SBM Bank Limited mature within 20 months from the balance sheet date.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 14. CASH BALANCES WITH CENTRAL BANK OF KENYA

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Gross Cash reserve requirement	1,019,137	1,029,133
Less: allowance for credit losses (Note (11(b)))	(34)	(34)
	<b>1,019,103</b>	<b>1,029,099</b>

As at 31 December 2019, the cash ratio requirement was 5.25% (2018: 5.25%) of eligible deposits. These funds are not available for the day to day operations of the Bank and are non-interest bearing.

### 15. LOANS TO CUSTOMERS

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Gross loans to customers	21,055,574	19,180,523
Interest receivable from loans and advances to customers	1,194,184	1,038,934
Less: allowance for credit losses (Note (11(b)))	(2,473,016)	(2,245,769)
	<b>19,776,742</b>	<b>17,973,688</b>

The effective interest rate on customer advances at 31 December 2019 was 20.4% (2018 – 19.7%). Advances to customers are secured by cash collaterals (note 22) and chattels mortgages. Other forms of collateral include land, buildings, and motor vehicles.

### 16. GOVERNMENT SECURITIES

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
<b>Treasury bonds - Amortised cost</b>		
Maturing within 1 year	1,400,000	200,000
Maturing between 1 and 3 years	300,000	-
Maturing over 3 years	1,800,000	1,400,000
	<b>3,500,000</b>	<b>1,600,000</b>
<b>Treasury bonds - Amortised cost</b>		
	-	300,000
	<b>3,500,000</b>	<b>1,900,000</b>
Less: allowance for credit losses (Note (11(b)))	<b>(30,622)</b>	<b>(20,100)</b>
	<b>3,469,378</b>	<b>1,879,900</b>

The effective interest rate on government securities during the year ended 31 December 2019 was 14.4% (2018 – 10.5%)

Treasury bonds worth Shs 300 million are pledged as security for the Absa Bank Kenya PLC borrowing shown on note 24.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 17. OTHER ASSETS

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Staff receivables	14,442	10,236	14,442	10,236
Prepaid expenses	96,265	112,416	96,265	112,817
Deposits and sundry receivables	170,128	217,229	168,735	217,229
Commission receivable	2,489	8,669	-	-
	<b>283,324</b>	<b>348,550</b>	<b>279,442</b>	<b>340,282</b>
Less: allowance for credit losses (Note (11(b)))	(14,397)	(16,663)	(13,949)	(15,512)
	<b>268,927</b>	<b>331,887</b>	<b>265,493</b>	<b>324,770</b>

### 18. INVESTMENTS IN SUBSIDIARY AND ASSOCIATE COMPANY

#### (a) Investments in associate company

	GROUP AND BANK	
	2019 Shs '000	2018 Shs '000
<b>Faulu Advisory Services Limited:</b>		
At 1 January	51,424	48,181
Share of profit for the year	2,307	4,632
Share of taxation (note 12(a))	(692)	(1,389)
At 31 December	<b>53,039</b>	<b>51,424</b>

The reporting date of Faulu Advisory Services Limited is 31 December. The company is incorporated in Kenya which is also its principal place of business. The Bank holds 25% ownership interest in the associate company. Its principal activity is guaranteeing loans advanced by Faulu Microfinance Bank Limited and training beneficiaries of microfinance loans on business related courses.

Summarised financial information below represents amounts shown in the associate's unaudited financial statements (adjusted by the company for equity accounting purposes) as of 31 December:

	2019 Shs '000	2018 Shs '000
Non-current assets	3,844	7,696
Current assets	25,045	189,194
	28,889	196,890
Current liabilities	<b>(28,889)</b>	<b>(112,915)</b>
Revenue	14,052	64,116
Profit from continuing operations before tax	9,229	18,530
Other comprehensive income	-	-
Total comprehensive income	9,229	18,530

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 18 INVESTMENTS IN SUBSIDIARY AND ASSOCIATE COMPANY (Continued)

#### (b) Investments in Faulu Microfinance Bank Insurance Agency Limited

The group financial statements include the results of a subsidiary of Faulu Microfinance Bank Limited, Faulu Microfinance Insurance Agency Limited. The principal activity of the company is the provision of insurance agency services,

The subsidiary company's financial year-end is 31 December and are incorporated as limited liability companies. They are incorporated in Kenya under the Companies Act and domiciled in Kenya.

This subsidiary is 100% owned and fully controlled by the Bank. This investment is recognised at a cost of Shs. 1,000,000 (2018: Shs. 1,000,000) in the Bank's financial statements.

There are no significant restrictions on the ability of the group to access or use assets and settle liabilities.

The results and net assets of the consolidated subsidiary company are as outlined below:

Faulu Microfinance Bank Insurance Agency Limited

	2019	2018
	Shs '000	Shs '000
<b>Summarised statement of financial position</b>		
Total assets	67,627	57,985
Total liabilities	(19,286)	(27,626)
Net assets	<b>48,341</b>	<b>30,359</b>
<b>Summarised statement of profit and loss and other comprehensive income</b>		
Revenue	34,144	31,279
Profit before income tax	25,947	13,745
Income tax expense	(7,964)	(4,207)
Total comprehensive income for the year	<b>17,983</b>	<b>9,538</b>
<b>Summarised statement of cash flows</b>		
Net cash generated from operating activities	12,634	10,715
Net cash generated from investing activities	-	(195)
Net increase in cash and cash equivalents	<b>12,634</b>	<b>10,520</b>
Cash and cash equivalents at beginning of year	<b>49,926</b>	<b>39,406</b>
Cash and cash equivalents at end of year	<b>62,560</b>	<b>49,926</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 19 DEFERRED TAX (ASSET)/ LIABILITY

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
The net deferred tax asset is attributable to the following items:				
Excess depreciation of capital allowances	131,510	68,928	131,503	68,913
Deferred tax on revaluation surplus	97,615	97,724	97,615	97,724
Bonus provision	(24,104)	(4,507)	(24,104)	(4,507)
Provision for staff leave pay	(5,636)	(7,307)	(5,636)	(7,307)
Impairment loss allowance	(755,747)	(607,961)	(755,613)	(607,496)
Other provisions	(28,436)	(8,040)	(28,436)	(8,040)
	<b>(584,798)</b>	<b>(461,163)</b>	<b>(584,671)</b>	<b>(460,713)</b>
The movements in the deferred tax account during the year were as follows:				
At 1 January	(461,163)	(440,285)	(460,713)	(440,285)
Credit to profit or loss (note 11(a))	(123,630)	(20,878)	(123,958)	(20,428)
Prior year under provision of deferred tax asset	(5)	-	-	-
At 31 December	<b>(584,798)</b>	<b>(461,163)</b>	<b>(584,671)</b>	<b>(460,713)</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 20. PROPERTY AND EQUIPMENT –GROUP

	Freehold land and buildings Shs '000	Motor vehicles Shs '000	Computers and equipment Shs '000	Electronic office equipment Shs '000	Durable non-electrical equipment Shs '000	Work in progress (WIP) Shs '000	Total Shs '000
<b>COST/VALUATION</b>							
At 1 January 2018	405,000	25,308	169,154	150,687	1,561,694	35,255	<b>2,347,098</b>
Additions	-	-	4,113	1,868	14,709	128,367	<b>149,057</b>
Transfer to/(from) WIP	-	-	3,688	18,807	54,586	(77,081)	<b>-</b>
Assets written off	-	-	(15,500)	-	(8,457)	-	<b>(23,957)</b>
Transfer to intangible assets	-	-	-	-	-	(5,331)	<b>(5,331)</b>
<b>At 31 December 2018</b>	<b>405,000</b>	<b>25,308</b>	<b>161,455</b>	<b>171,362</b>	<b>1,622,532</b>	<b>81,210</b>	<b>2,466,867</b>
At 1 January 2019	405,000	25,308	161,455	171,362	1,622,532	81,210	<b>2,466,867</b>
Additions	-	19,753	17,416	21,854	10,549	24,355	<b>93,927</b>
Transfers	-	-	-	-	-	-	<b>-</b>
Assets written off	-	-	(29,577)	(4,432)	(32,697)	(21,055)	<b>(87,761)</b>
Disposals	-	(5,000)	-	-	-	-	<b>(5,000)</b>
<b>At 31 December 2018</b>	<b>405,000</b>	<b>40,061</b>	<b>149,294</b>	<b>188,784</b>	<b>1,600,384</b>	<b>84,510</b>	<b>2,468,033</b>
<b>DEPRECIATION</b>							
At 1 January 2018	-	18,865	133,506	89,657	686,568	-	<b>928,596</b>
Charge for the year	6,302	1,611	10,037	15,989	110,480	-	<b>144,419</b>
Eliminated on write off	-	-	(14,901)	-	(5,909)	-	<b>(20,810)</b>
<b>At 31 December 2018</b>	<b>6,302</b>	<b>20,476</b>	<b>128,642</b>	<b>105,646</b>	<b>791,139</b>	<b>-</b>	<b>1,052,205</b>
At 1 January 2019	6,302	20,476	128,642	105,646	791,139	-	<b>1,052,271</b>
Charge for the year	1,218	2,371	13,492	18,191	96,317	-	<b>131,589</b>
Eliminated on write off	-	-	(27,407)	(3,652)	(26,485)	-	<b>(57,544)</b>
Eliminated on disposals	-	(4,178)	-	-	-	-	<b>(4,178)</b>
<b>At 31 December 2019</b>	<b>7,520</b>	<b>18,669</b>	<b>114,727</b>	<b>120,185</b>	<b>860,971</b>	<b>-</b>	<b>1,122,072</b>
<b>NET BOOK VALUE</b>							
At 31 December 2019	397,480	21,392	34,567	68,599	739,413	84,510	<b>1,345,961</b>
<b>At 31 December 2018</b>	<b>398,698</b>	<b>4,832</b>	<b>32,813</b>	<b>65,716</b>	<b>831,327</b>	<b>81,210</b>	<b>1,414,662</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 20 PROPERTY AND EQUIPMENT – GROUP

Land and buildings were revalued at Shs 405,000,000 as at 31 December 2017 by Gimco Limited, registered valuers.

At 31 December 2019, the net book value of the freehold land and building based on original cost was Shs 48,561,584 (2018: Shs 48,562,884).

The Group property and equipment 2019 balance of Shs. 1,345,564,433 (2018: Shs 1,414,662,000) includes the subsidiary's assets with a net book value of Ksh 397,000 (2018: Ksh 492,000).

During the year, management carried out a review, of the working condition of the Bank's computers and office equipment. This review resulted in the write off of assets, whose total value was Shs 66,706,000 (2018: Shs 23,957,000) and had a carrying value of Shs 9,162,000 (Shs 3,147,000)

The write off of capital work in progress of Shs 21,055,000 relates to costs for development of Sales Force System initiated in 2015 to increase efficiencies in customer relationship management through loan origination, document management and workflows. The Bank upgraded to a higher version of T24 (R16), a more advanced system for loan management and thereby rendered the development costs of Sales Force System redundant.

The total assets written off to the income statement amounted to Shs 30,217,000 (2018: Shs 3,147,000).

Fair value measurement of the company's freehold land and buildings

The company's land and buildings are stated at their revalued amounts, being the fair values at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value measurements of the company's leasehold land and buildings as at 31 December 2017 were performed by Gimco Limited, registered and independent valuers (i.e. not related to the company). Gimco Limited are members of the Institute of Surveyors of Kenya and they have appropriate qualifications and relevant and recent experience in the fair value measurement of properties in the various locations in Kenya. The fair value of land was determined by reference to market evidence of recent transactions

for similar properties. The fair value of the building was based on the cost approach. Under this approach, the fair value is estimated at the cost of erecting a building adjusted to take into account the physical state of the actual structure.

Details of the company's freehold land and buildings and information about fair value hierarchy as at 31 December 2019 are as follows:

	Level 1 Shs '000	Level 2 Shs '000	Level 3 Shs '000	Fair value As at 31 December Shs '000
<b>31 December 2019</b>				
Land	-	350,000	-	350,000
Building	-	-	55,000	55,000
<b>31 December 2018</b>				
Land	-	350,000	-	350,000
Building	-	-	55,000	55,000

There were no transfers between level 1 and level 2 during the year.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 21. INTANGIBLE ASSETS – COMPUTER SOFTWARE

	GROUP AND BANK	
	2019 Shs '000	2018 Shs '000
<b>COST</b>		
At 1 January	1,335,886	1,290,171
Additions	10,873	40,384
Transfer from WIP (Note 20)	-	5,331
At 31 December	<b>1,346,759</b>	<b>1,335,886</b>
<b>AMORTISATION</b>		
At 1 January	458,325	269,746
Charge for the year	176,022	188,579
At 31 December	<b>634,347</b>	<b>458,325</b>
<b>NET BOOK VALUE</b>		
At 31 December	712,412	877,561

### 22. RIGHT-OF-USE ASSET

The Bank leases office space for its use. Information about the leases in which the Bank is a lessee is presented below:

	GROUP AND BANK
	2019 Shs '000
<b>COST</b>	
At 1 January	578,117
Additions	-
At 31 December	<b>578,117</b>
<b>ACCUMULATED DEPRECIATION</b>	
At 1 January	-
Charge for the year	124,250
At 31 December	<b>124,250</b>
<b>NET BOOK VALUE</b>	
At 31 December	<b>453,867</b>
Amounts recognised in profit or loss	
Depreciation expense on right-of-use assets	124,250
Interest expense on lease liabilities	46,030
Expense relating to short term leases	-
Expenses relating to leases of low value assets	-
	<b>170,280</b>

The Group was not committed to any arrangements that are short term as at year-end. All of the property leases in which the Group is the lessee contain only fixed payments.

The total cash outflow for leases amounted to Kshs 135,490,000 (2018: Kshs 135,600,000). There are no restrictions or covenants imposed by lessors and the Group did not enter into any sale and leaseback transactions during the year (2018: Nil).

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 23. CASH COLLATERALS HELD

Cash collaterals represent payments made by loanees as security for loans taken. In accordance with the loan agreements, the amounts are refundable upon the successful repayment of loans by loanees and at the time a loanee leaves the loan scheme. The amounts are utilised to cover loans in the event of default.

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
0 - 30 days	438,362	500,249
31 - 90 days	21,301	16,491
91 - 180 days	9,715	12,107
Over 180 days	<b>21,685</b>	<b>59,997</b>
	<b>491,063</b>	<b>588,844</b>

The effective interest rate on the cash collaterals held at 31 December 2019 was nil (2018: nil).

### 24. CUSTOMER DEPOSITS

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
Savings account	2,527,583	2,377,332	2,542,143	2,384,728
Fixed account	17,011,157	15,514,240	17,059,157	15,556,240
	<b>19,538,740</b>	<b>17,891,572</b>	<b>19,601,300</b>	<b>17,940,968</b>

The effective interest rate on customer deposits as at 31 December 2019 is 10.7% p.a (2018: 11% p.a).

### 25. BORROWINGS

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
<b>Loans:</b>		
Standard Chartered Bank Kenya Limited	111,111	527,778
Symbiotics SA	1,015,141	712,774
European Investment Bank	236,600	473,200
Oiko	450,000	600,000
IFAD	117,784	157,046
Absa Bank Kenya PLC	435,639	959,722
Stanbic Bank Kenya Limited	2,000,000	1,000,000
	<b>4,366,275</b>	<b>4,430,520</b>
<b>The borrowings are repayable as follows:</b>		
Within 1 year	1,256,944	2,430,520
After 1 year within 3 years	3,109,331	2,000,000
	<b>4,366,275</b>	<b>4,430,520</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

During the year, additional debts were acquired from the following:

Shs 1 billion from Stanbic Bank Limited with interest rate pegged to the Central Bank Rate (CBR) plus a margin of 2.00% repayable in 1.5 years every three months, Shs 487 Million from Absa Bank Kenya PLC payable with a maximum repayment period of 1 year and repayment is through direct monthly debits from the account. They are secured by government securities with a value of Shs 200 million.

USD 4 Million Kenya Shilling equivalent was also acquired from Symbiotic with a repayment period of 24 months (2 years) at a rate of 12.00% for USD 2 Million negotiated in March 2019 and 11.50% for USD 2 Million agreed in the month of April 2019.

The Bank overdrafts was held at Standard Chartered Bank Kenya Limited ("SCB") for working capital requirements, the SCB overdraft was undrawn with a limit of Shs. 250 million. The interest rates are pegged to the Central Bank Rate (CBR) plus a margin of 2.1%.

IFAD (International Fund for Agricultural Development) loan of Shs 200.2 million ( Current balance Shs 117million) was granted by the Government of Kenya through Profit Fund in February 2012. It is aimed at promoting financial deepening in the rural sector by availing access to credit for agricultural related projects. The loan period is 10 years with a four-year grace period all-inclusive at an interest rate of 5% on reducing balance.

The effective interest rate on the other borrowings for prior years are as follows: SCB (11.5%) Symbiotics (11.8%); European Investment Bank (10.31%); Oiko (10%); IFAD (5%).

### Covenant Breaches

Faulu Microfinance Bank Limited has existing covenants with its lenders which requires the Bank to maintain certain minimum Non Performing ("NPL") ratio. The covenants breaches in the course of the year were mitigated through the renegotiation of the covenant's conditions and therefore no Breaches existed as at 31st December 2019.

Contract changes done in the course of the year included: EIB from 15% to 14% of Total capital to Risk weighted asset ratio and Nonperforming loans ratio ("NPL") from 12% to 13.5%. Oiko covenant changed from NPL to UCR, the UCR limits are as follows: Dec 2018 to June 2019 UCR less or equal to 25%, June 2019 to December 2019 UCR less or equal to 20% and January 2020 onwards UCR less or equal to 15%. Stanbic Bank covenant was reviewed to have 90 days NPL between 10% to 12%. Absa Bank Kenya PLC's changed Total capital to Risk weighted Asset Ratio from 15% to 14%.

The Bank management engaged the lenders on the quality of the loan book and the lenders accepted to review the covenants in favour of the bank.

## 26. OTHER LIABILITIES

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Accrued expenses	176,691	147,263	171,189	141,673
Staff leave provision	18,785	24,355	18,785	24,355
Bonus provision	80,348	39,974	80,348	39,974
Sundry liabilities	584,523	529,331	576,835	521,119
	<b>860,347</b>	<b>740,923</b>	<b>847,157</b>	<b>727,121</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 27. LEASE LIABILITY

GROUP AND BANK	
	2019
	Shs '000
Year 1	-
Year 2	19,701
Year 3	97,143
Year 4	92,862
Year 5	185,458
Onwards	93,495
	<b>488,659</b>

The group does not face a significant liquidity risk with regards to its lease liabilities. Lease liabilities are monitored within the group's treasury function.

The movement in the lease liabilities is as follows:

GROUP AND BANK	
	2019
	Shs '000
At 1 January 2019	-
Additional lease liabilities	19,701
Interest on lease liabilities	97,143
Payment of lease liabilities	93,495
<b>At 31 December 2019</b>	<b>488,659</b>

### 28. SHARE CAPITAL

	GROUP		BANK	
	2019	2018	2019	2018
	Shs '000	Shs '000	Shs '000	Shs '000
Authorised:				
60,000,000 ordinary shares of Shs 10 each	600,000	600,000	600,000	600,000
Authorised, issued and fully paid:				
48,000,000 ordinary shares of Shs 10 each	<b>480,000</b>	<b>480,000</b>	<b>480,000</b>	<b>480,000</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 29. NOTES TO THE STATEMENT OF CASH FLOWS

#### a) RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Profit before taxation	482,419	287,360	456,472	273,615
Adjustment for:				
Depreciation on property and equipment	131,589	144,419	131,494	144,297
Depreciation on right-of-use assets	124,250	-	124,250	-
Amortisation of computer software	176,022	188,579	176,022	188,579
Write off of assets	30,217	3,147	30,217	3,147
Gain on disposal of a motor vehicle	(543)	-	(543)	-
Share of associate company's profit	(2,307)	(4,632)	(2,307)	(4,632)
Interest on lease liability	46,032	-	46,032	-
	<b>987,679</b>	<b>618,873</b>	<b>961,637</b>	<b>605,006</b>
Working capital changes:				
Increase in loans to customers	(1,803,054)	23,140	(1,803,054)	23,140
IFRS 9 transition adjustment	-	(1,917,136)	-	(1,917,136)
Prior year adjustment relating to prior years' suspended interest	-	140,086	-	140,086
Net movement in related party balances	6,150	21,849	16,184	29,164
Decrease /(increase) in other assets	62,960	(464,346)	59,277	(463,533)
Decrease in cash collaterals held	(97,781)	(123,113)	(97,781)	(123,113)
Increase in customer deposits	1,647,698	2,199,698	1,660,332	2,202,822
Increase in other liabilities	119,424	88,289	120,036	88,176
(Increase) / decrease in government securities	(1,589,478)	620,100	(1,589,478)	620,100
Decrease/(increase) in cash reserve ratio-CBK	9,996	(246,114)	9,996	(246,114)
	<b>(656,406)</b>	<b>962,765</b>	<b>(662,851)</b>	<b>958,598</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### b) ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
Cash and bank balances	620,888	1,027,193	620,888	1,027,193
Short term deposits with banks (note 13)	1,349,702	1,963,446	1,349,702	1,963,446
	<b>1,970,590</b>	<b>2,990,639</b>	<b>1,970,590</b>	<b>2,990,639</b>

### c) MOVEMENT IN BORROWINGS

	GROUP AND BANK		GROUP AND BANK	
	2019 Shs '000	2019 Shs '000	2019 Shs '000	2019 Shs '000
At 1 January		4,430,520		3,571,774
Received in the year		1,889,657		2,551,174
Paid in the year		(1,953,902)		(1,692,428)
<b>At 31 December</b>		<b>4,366,275</b>		<b>4,430,520</b>

## 30. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

Old Mutual Holdings Limited is the principal shareholder of Faulu Microfinance Bank Limited.

Old Mutual Holdings Limited, Faulu Kenya Trust and Food for the Hungry Association (FH) are shareholders in Faulu Microfinance Bank Limited.

Faulu Microfinance Bank Limited, Faulu Advisory Services Limited and Faulu Kenya Trust are also related by virtue of common control.

### Related company balances

	GROUP		BANK	
	2019 Shs '000	2018 Shs '000	2019 Shs '000	2018 Shs '000
from related parties:				
UAP Holdings Limited	27,169	41,514	27,169	41,514
Faulu MFB Insurance Agency Limited	-	-	2,489	12,523
	<b>27,169</b>	<b>41,514</b>	<b>29,658</b>	<b>54,037</b>
to related parties:				
UAP Insurance Limited	(8,236)	(16,472)	(8,236)	(16,472)
Old Mutual Life Assurance Limited	(57,173)	(57,132)	(57,173)	(57,132)
	<b>(65,409)</b>	<b>(73,604)</b>	<b>(65,409)</b>	<b>(73,604)</b>

transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers. Amounts not settled as at the end of each reporting period in respect of transactions with related parties are disclosed under note 29.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 30 RELATED PARTY TRANSACTIONS (Continued)

Deposits are made in the Bank by directors and companies associated to directors. Advances to customers at 31 December 2019 include advances and loans to staff and directors as indicated below:

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Advances to customers:		
- Directors	39,561	24,006
- Employees	343,335	232,611
At 31 December	<b>382,896</b>	<b>256,617</b>
(d) Customer deposits:		
- Directors	17,727	98,859
- Employees	190,653	234,978
	<b>208,380</b>	<b>333,837</b>
(e) Related party transactions		
Group recharges from Old Mutual Holdings Limited	87,726	84,070

#### Key management compensation

The remuneration of directors and other members of key management during the year were as follows:

	GROUP AND BANK	
	2019	2018
	Shs '000	Shs '000
Salaries and other benefits	210,703	118,006
<b>Directors' remuneration</b>		
Fees for services as directors	14,409	13,490
	2019	2018
	numbe	numbe
<b>Average Number of Employees</b>		
Senior management	11	11
Number of staff	547	531
<b>Total employees</b>	<b>558</b>	<b>542</b>

### 31. CONTINGENT LIABILITIES

The company is a defendant in various legal suits with an estimated liability of Shs 95.2 million (2018 - Shs 94 million). In the opinion of the directors, after obtaining appropriate legal advice, the outcome of such actions will not give rise to any significant loss.

### 32. CAPITAL COMMITMENTS

The company had commitments worth Shs 104 million. (2018: Shs 178 million).

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### 33. SHAREHOLDING STRUCTURE

The shareholding structure is analysed as follows:

	No of Shares	% of Holding
Old Mutual Holdings Limited	32,160,000	67%
Micsha Capital Limited	3,840,000	8%
Food for the Hungry Association	4,800,000	10%
The Faulu Kenya Trust	7,200,000	15%
	<b>48,000,000</b>	<b>100%</b>

### 34. OPERATING SEGMENTS INFORMATION

The entity's business is not organised on the basis of differences in related products and services or differences in geographical areas of operation.

### 35. ULTIMATE AND IMMEDIATE HOLDING COMPANY

The immediate holding and parent company is Old Mutual Holdings Limited, a company incorporated and domiciled in Kenya under the Companies Act. The ultimate holding company is Old Mutual Plc. which is incorporated in United Kingdom.

### 36. INCORPORATION

Faulu Microfinance Bank Limited is domiciled and incorporated in Kenya under the Companies Act.

### 37. EVENTS SUBSEQUENT TO YEAR END

On Monday, March 16, 2020, the Central Bank of Kenya (CBK) announced a set of measures that commercial banks will undertake in order to alleviate the adverse economic effects, banking customers may face from the Coronavirus pandemic (COVID-19). These measures include extension of loans for a period of up to one year and restructuring of loans. The Bank is required to meet all the costs related to the extension and restructuring of loans. It is anticipated that these measures may impact the Bank's profitability for the year ended 31 December 2020 in respect of interest income, administration costs and modification losses arising from IFRS 9 requirements. The Bank is however unable to quantify the impact of these measures announced by the Central Bank of Kenya.

### 38. CURRENCY

These financial statements are presented in Kenya Shillings thousands (Shs'000).

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# 2019 Annual Report



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